

LEGAL FEES REVIEW PANEL

REPORT

LEGAL COSTS IN NEW SOUTH WALES

December 2005

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LEGAL FEES REVIEW PANEL

LEGAL COSTS IN NEW SOUTH WALES

1. CONTEXT FOR POLICY PROPOSALS RELATING TO LAWYERS' CHARGES

1.1 The Legal Fees Review Panel and the purpose of this paper

In February 2004 the Premier called for an inquiry examining the current legal costs system, the calculation of prices and the methods by which bills were presented to a client. The inquiry was also to look into the mechanisms through which a client can object to fees they consider unfair, and or negotiate other arrangements.

To effect these aims the Premier established a Legal Fees Review Panel (the Panel) comprising Mr Laurie Glanfield, Director General of the Attorney General's Department; Mr Ian Harrison SC, President, NSW Bar Association; Mr Gordon Salier, President, Law Society of NSW and Mr Steve Mark, Legal Services Commissioner.

In September 2004 the Panel issued a wide-ranging discussion paper (the Discussion Paper) which:

- examined the issues which flow from the pricing and billing practices of the legal profession, primarily as identified in complaints made to the Office of the Legal Services Commissioner (OLSC) concerning those practices;
- canvassed a number of alternative pricing structures for legal services;
- sought responses from key stakeholders and the public.

Having considered these responses, and consulted further with a number of key stakeholders, the purpose of this paper is to propose a strategic policy framework for reform, and within that framework to put forward options for particular steps which may be taken.

1.2 The context of the discussion – concern about legal fees.

Concern about the level of lawyers' fees, and the image of the avaricious lawyer, is a recurrent theme from Ancient Roman times to the present day. It is one which often distracts from consideration of the positive contributions that lawyers, and the legal profession as a whole, make to the smooth and effective running of societies and economies.

In the present day, media comment often reflects on the high cost of justice, and consequent difficulties of access, with particular focus on the cost of litigation.

This social context is important in considering the policy framework within which lawyers' fees are to be regulated. The concern is perennial, and derives in no small part from the fact that, at least as far as individuals are concerned, most people encounter lawyers and the law at times of heightened sensitivity and vulnerability, often when they need to make urgent and emotionally charged decisions in areas well beyond their experience and training. The image, and the complaint, have to a significant degree become stereotypes, and stereotypes are not sound underpinnings for policy.

1.3 How real is the perception of excessive lawyers' fees?

The perception that lawyers' fees are too high, and that the level of these fees makes access to justice unduly expensive, is a persistent one, particularly in the media, and it is difficult to assess its accuracy.

One of the major contributing factors to this perception is the lack of publicly accessible information on the cost structures of legal practice. In the absence of this information it is very easy to assume that gross income correlates closely to net income for practitioners. This assumption is incorrect.

Information on the cost of overhead expenses is collected by the Law Society, and indicates that the majority of the gross fee dollar is eaten up by overhead expenses, regardless of the size or location of the law firm. Figure 1 below is a summary of statistics provided to the panel by the Law Society.¹

¹ Information supplied by Law Society of New South Wales. Research undertaken and breakdowns prepared by Financial Management Resource Centre, University of New England, New South Wales

Figure 1 - Overhead expenses as percentage of gross fee dollar

| | |
|---|-------|
| Sole practitioner, CBD | 69% |
| Sole practitioner, large regional city | 73.3% |
| Sole practitioner, small country town | 62.8% |
| Two principal firm, CBD | 67.8% |
| Two principal firm, large regional city | 65.4% |
| Three to four principals, CBD | 65.5% |
| Three to four principals, city suburban | 69.8% |
| Large firm, averaging 56 principals | 64.8% |

In assessing the reality of the perception, it is also instructive to consider the views expressed by those who participate in the legal system at senior levels. Such commentators have regularly highlighted the increasing cost of access to the courts.

In 1999 the then Attorney General, Michael Lavarch, directed the Australian Law Reform Commission to enquire into Australia’s adversarial system of litigation “having regard to the need for a simpler, cheaper and more accessible legal system”.²

The problem of rising litigation costs is the product of a number of factors, many of which are systemic. The processes of the courts themselves, and the procedures which they dictate, support high costs and the taxation system provides an incentive for businesses to litigate, at the expense of individuals. (These aspects are further discussed in Section 1.6 below). Of course these are not the only causes. For many years, senior judges in Australia and the United States have noted the contribution of lawyers’ fees to the problem.

In the United States, then Chief Justice Rehnquist observed in 1999 that “if one is expected to bill more than two thousand hours a year, there are bound to be temptations to exaggerate the hours actually put in”.³

In Australia, Mr Justice Davies of the Queensland Court of Appeal observed in 1995 that litigation presented “a number of problems caused either by the

² Australian Law Reform Commission, Terms of Reference for ALRC 89 Review of the *Adversarial System of Litigation*

³ Rehnquist, “Dedicatory Address: The Legal Profession Today” 62 *Ind. L. J.* 151, 155. (1987)

excessiveness of costs in proportion to the amount in dispute or their unpredictability”.⁴ In his speech for the Opening of Law Term in 2004, Chief Justice Spigelman referred to “the belief that the legal process eats up too high a proportion of what is at stake” and noted his belief that time billing is unsustainable since “it is difficult to justify a system in which inefficiency is rewarded with higher remuneration”. In making the last remark, Chief Justice Spigelman also noted that this was a view shared by Chief Justice Gleeson of the High Court.⁵

Most of these are not mere external commentators. They are, or have been, senior players in the justice system, dealing with practitioners and litigants on a daily basis. Each was a senior and long experienced practitioner, having been either or both of barrister or solicitor. They understand the operation of time based pricing intimately, having experienced, administered and observed it personally for decades.

Another indicator is the data relating to complaints about lawyers.

It should be borne in mind that complaints are an imperfect foundation upon which to construct a model of current professional practice. In any complaint based system one must assume that there are those who have a basis for complaint yet choose not to pursue it, those who are silent because they are satisfied with the services they receive and those who directly address their own issues and resolve them without external intervention. In the absence of detailed research data, there is no way to quantify these groups or to analyse their motivations. Since no such research has been conducted in New South Wales, the body of complaints data is presently the only body of data available.

In the United States, the most common source of client discontent at the end of the twentieth century was fee disputes.⁶ Chief Justice Spigelman also stated that it was only a handful of members of the profession who exploited their position by providing services that either do not need to be provided at all or provide them in a more luxurious manner than is appropriate.⁷

In New South Wales, the number of clients applying for assessment of their legal practitioners’ bills has been increasing over recent years, although it is still true that the great majority of costs assessment applications relate to

⁴ Hon Justice G.L. Davies, “A Blueprint for Reform: Some Proposals of the Litigation Reform Commission and their Rationale” (1996) *Journal of Judicial Administration* 201,203

⁵ Hon. Justice J.J. Spigelman, *Opening of Law Term Dinner 2004*, www.lawlink.nsw.gov.au/sc/sc.nsf/pages/Spigelman_040202

⁶ Sonia S. Chan “ABA Formal Opinion 93-979: Double Billing, Padding and Other Forms of Overbilling” (1996) 9 *Georgetown Journal of Legal Ethics* 611, 612

⁷ Spigelman, *op.cit.*

party/party costs awarded after litigation rather than solicitor/own client costs disputes.⁸

The Discussion Paper canvassed the issues raised by costs related complaints to the OLSC in considerable detail, which does not need to be repeated here. However it is instructive to note the following:

- Complaints very often encompass broad classes of issues, and even complaints about incompetence, failure to communicate or general ethical breaches almost always raise concern about the value or cost of the service provided.
- Almost one third of telephone enquiries to the OLSC in the 2003 –2004 year specifically related to costs, including issues of overcharging and failure to disclose.⁹
- Approximately 17% of formal written complaints to the OLSC in the 2003-2004 year specifically related to costs issues, with 8.9% relating specifically to complaints of overcharging.¹⁰

There are presently approximately 20,000 solicitors and approximately 2,000 barristers admitted to practice in New South Wales, who between them handle many thousands, if not millions, of transactions each year. By comparison, the number of complaints about fees and charges is small. The number of complaints upheld is even smaller. Even allowing for significant non-reporting, and the tendency of large consumers to handle their own grievances rather than seek regulatory intervention, it appears that it is correct to say that the majority of practitioners operate ethically and properly.

Commercial lawyers in Australia and the United States generally report that they believe their clients are satisfied with their ability to manage legal fees, and like (or are at least neutral towards) time billing.¹¹ This may be because the impact of sizeable legal expenditures on artificial persons is considerably less, particularly in emotional terms, than it is on natural persons. Corporate managers are generally distinct from the owners of the company, and consequently not emotionally involved in decisions about spending what is in effect other people's money. There are also significant community subsidies for legal expenses available to companies in the form of tax concessions (discussed in Section 1.6 below).

⁸ Robert Benjamin, *Costs Assessors' Rules Committee Submission to Legal Fees Review Panel*, p 1

⁹ Office of the Legal Services Commissioner, *Annual Report 2003-2004*, Table P2

¹⁰ *ibid.* Table W2

¹¹ See for example, Ian Robertson, "Don't Get Tied Up in Numbers" *Australian Financial Review* 3 June 2005 p 59; Missouri Bar Association, *Final Report of the Missouri Bar Alternative Billing Methods Committee*, September 15, 2003 p 10

In a submission in response to the Discussion Paper made on behalf of nine of the largest commercial law firms in New South Wales, Bruce Cutler and Alan Cameron observe:

The clients of these firms are almost exclusively sophisticated purchasers of legal services; they often require competitive tenders for legal work; they usually negotiate fees in a competitive environment; they usually expect the firms to make full disclosure of which solicitors are working on a matter, time spent and on what, and require regular updates of fee estimates especially for litigation and large corporate matters. In this competitive environment it is the client who specifies, and requests, in the tender process that firms nominate the hourly rates for different categories of solicitors and requires the disclosures referred to above. Where these clients insist on hourly billing as the basis of charging, they do so in the belief that hourly billing will produce the accountability for the cost of their legal services which they require.¹²

The satisfaction of big firms' clients is in no small part due to the fact that most are sophisticated corporates with significant market power. They are able to, and do, demand reductions and variations and engage in high-level negotiations about the basis on which the services they acquire are priced.¹³

Consumers such as these do not present their complaints to the OLSC. They do not need to. There are no data available as to the number, nature or resolution of disputes about charging which are addressed directly with large commercial firms, so the scope and frequency of their problems are unknown.

It is worth bearing in mind the possibility that the law firms' views of their clients' levels of satisfaction may not be entirely accurate. In 1991, research undertaken in the United States by Professor William G. Ross found that corporate counsel were far more likely than private practitioners to believe that time billing led to extra work being done on a file. They were generally sceptical of their private firm colleagues' billing practices although, while pressing for greater accountability, they were not generally so dissatisfied as to demand alternative billing practices.¹⁴

Whatever level of comfort presently exists, it may not last. Respected American legal consultants, Hildebrandt Inc, state that client resistance to high legal fees, particularly those priced on the basis of time, is increasing. Hildebrandt:

¹² Bruce Cutler & Alan Cameron, *Submission to the Legal Fees Review Panel – Comments from the Perspective of Large Firms*. Firms represented in this response were Allens Arthur Robinson, Blake Dawson Waldron, Clayton Utz, Corrs, Deacons, Freehills, Mallesons, Minter Ellison and Phillips Fox.

¹³ Richard P. Delaney, "A Letter from the Corporate Counsel", *Beyond the Billable Hour* Richard Reed (ed). 1989 ABA Law Practice Management Section, 44

¹⁴ William G. Ross, "The Ethics of Hourly Billing by Lawyers" (1991) 44 Rutgers Law Review 1 at 5-22

believe that the legal profession may well be heading for a 'show down' between major law firms and their corporate clients around issues of rates and profitability

and predicted that

client 'push back' on rates and overall legal costs will continue to mount in 2005, and that firms will continue to feel strong pressures for discounts, for rates locked over multiple year periods, for fixed fees and other accommodations. These pressures will be particularly severe with more commoditized services, but few practices are likely to escape unscathed.¹⁵

This prediction appears to be playing out in Australia.

A survey conducted in April 2005 by the Australian Corporate Lawyers' Association showed that almost 60 percent of companies were seeking alternatives to hourly rates from their legal advisers.¹⁶ *The Australian Financial Review* concludes that:

Australia's largest law firms are coming under pressure from corporate clients to deliver more services for less money as organisations search for new ways to reduce costs.¹⁷

The outgoing national chairman of Blake Dawson Waldron, Mr Richard Fisher, has noted that routine legal work is increasingly being done by in-house lawyers, who are looking closely at the value added by their external colleagues.¹⁸

The effect of this shift is well illustrated by announcements from major Australian banks, traditionally blue chip clients of blue chip Australian law firms. Westpac has announced that, from 1 July 2005, it will be combining its Australian and New Zealand legal panels to take advantage of lower costs in New Zealand, and ANZ has also publicly considered moving its work to New Zealand.¹⁹ ANZ's general counsel, Tim L'Estrange (a former managing partner of Allens Arthur Robinson) commented:

¹⁵ Hildebrandt Inc, *2005 Client Advisory*, www.hildebrandt.com

¹⁶ Marcus Priest, "Time is up for lawyers' hourly billing" *Australian Financial Review* 17 May 2005 p 3

¹⁷ Katherine Towers, Susannah Moran, Marcus Priest, "Judgement day: lawyers feel heat over costs, services" *Australian Financial Review* 16 May 2005 p. 1.

¹⁸ Marcus Priest, "Padbury in Charge of Blakes Partners" *Australian Financial Review* 3 June 2005 p 57

¹⁹ Towers, Moran & Priest, *loc. cit.*

I don't see an attack on costs. I don't see the firms challenging the way they do our business.²⁰

The managing partner of Gadens, Michael Bradley, has concluded that

it is going to be harder and harder outside of litigation to justify time-based billing for any type of work²¹

a position with which Richard Willcock, group secretary and general counsel for Westpac, agrees. The *Australian Financial Review* reports that Mr Willcock says

law firms have yet to position themselves in valuing their services. Firms should look to model themselves on investment banks instead of being chained to the billable hour.²²

1.4 The role of solicitor/client communication

The Legal Services Commissioner, Steve Mark, notes that most cost related complaints are made after a matter has been completed, and often when a client is surprised by the cost, especially if the outcome is less than was desired. The majority of complaints received at the OLSC contain an element of failure to communicate, or poor communication between practitioner and client, particularly in areas relating to the status of a matter and the accumulation of costs as it progresses.²³

This suggests that communication between solicitor and client is an important factor in determining clients' perception of having received value from their lawyers, and hence their satisfaction with their lawyers' fees. Research conducted into the hourly billing practices of accountants supports this view. It indicates that clients' perception of the appropriateness or otherwise of the fees charged is secondary in their evaluation of professional services to considerations of the way in which the accountant treated them, and whether they felt ignored. Once dissatisfied on these grounds, they are more likely to feel dissatisfied about the value of what they have paid for.²⁴

²⁰ *ibid.*

²¹ *ibid*

²² *ibid.*

²³ Steve Mark, "The Cost of Justice or Justice in Costs – The Experiences of the OLSC in Handling Costs Complaints" (2004) 27(1) *UNSW Law Journal* 225, 226-227

²⁴ Ronald J. Baker, *Burying the Billable Hour*, Certified Accountants Educational Trust, 2001 pp 8-11 published on www.accaglobal.com

1.5 Time billing

Arguments about the fairness and appropriateness of time records as a pricing mechanism are central to the current debate about the level of legal fees.

Keeping time records became a management imperative for American law firms in the 1950's and 1960's. In 1958, a committee of the American Bar Association published a pamphlet, entitled "*The 1958 Lawyer and His 1938 Dollar*", which urged lawyers to become more business-like in their work practices, starting with keeping time records in order to assess the cost to their firms of delivering their services to clients.²⁵ Over the next decade consultants began advocating the practice, pointing out that lawyers who recorded time made more money.²⁶

In New South Wales prior to 1994, statutory fee scales were used to specify the amount that solicitors could charge their clients for certain types of work. It was possible to contract out of the scales and the practice developed of obtaining written agreements from clients allowing non-scale fees to be charged. Initially time records were used as an indicator, with the price charged being adjusted according to what the solicitor thought appropriate, taking into account a number of factors which may have included any or all of the time involved, the complexity of the work, the means of the client, the result obtained or just the sheer volume of the file. The movement away from scale costs began with larger, commercially oriented firms and spread gradually to smaller firms. Scales continued to be attractive to some small firms, who used them until they were finally abolished. The attraction lay in their simplicity and predictability, both in terms of the final bill and the nature of the records required. A further attraction was the ability to avoid discussing price with clients, since the scales were externally determined.

Beginning with the large commercial firms, hourly rates became the default charging mechanism, with the firms allocating a rate to each practitioner and calculating fees by multiplying time recorded by each practitioner's allocated price. With the abolition of scale costs, this practice (commonly known as time costing or time billing) is now the principal method of pricing for legal services in Australia and the rest of the English-speaking world, for both commercial and individual clients.

It is important to distinguish two fundamental concepts, which are often confused: the idea of cost, and the idea of price. Time recording is now used to price legal services, even though it was originally intended to cost them, i.e.

²⁵ Niki Kuckes, "The Hours T" *Legal Affairs*, September/October 2002
www.legalaffairs.org/issues/September-October-2002/review_kuckes-sepoct2002.html

²⁶ American Bar Association, *ABA Commission on Billable Hours Report 2001-2002*, ABA 2002, 3

to allow the firm to track and measure its inputs into providing its services to clients. The costing mechanism has now effectively become the product.²⁷

In theory, time based billing works very simply, which is one of its principal attractions both to practitioners and clients. The price per hour is agreed (or at least disclosed) in advance and the mechanism by which the final bill is calculated is readily transparent. It involves concepts everyone can understand- hours, minutes and dollars- rather than the arcane language of the schedules which spoke of counter-intuitive things like “folios” (a specified number of lines of text which was the basic charging unit for “perusal” of documents under the old scales).

Defining the scope of the market for legal services is a complex exercise. The Australian Competition Tribunal has endorsed a standard definition of a market as

..the area of close competition between firms, or the field of rivalry between them...Within the bounds of a market there is substitution between one product and another, and between one source of supply and another, in response to changing prices.²⁸

In a properly functioning market, well-informed consumers consider the information before them, including information about quality and price, and choose between competing products or services on that basis. In some markets, external factors operate to distort this process and therefore cause market failure.

“Information asymmetry” is one such distorting factor. It refers to the situation where consumers do not have the same access to knowledge about the goods and services on offer. They therefore have to make choices based on incomplete or inaccurate information, and their bargaining power is consequently reduced. Those consumers who have better access to information are in a better position to acquire the goods or services they need, while those who have less access are comparatively disadvantaged. In some cases, only the seller has the full information with the result that, as compared to the seller, all buyers are disadvantaged even if, as between themselves, some may be better placed than others. The inverse may also apply, with sellers being in positions of comparative ignorance.²⁹

²⁷ Kuckes, *op.cit.*

²⁸ Australian Competition Tribunal, cited by Attorney General's Department, Legislation & Policy Division, *National Competition Policy Review of the Professional Standards Act 1994* www.lawlink.nsw.gov.au/report/lpd_reports.nsf/pages/comp_profstand_4

²⁹ For a fuller discussion of the impacts of information asymmetry on the legal profession in New South Wales see Justice J. Spigelman, *Are Lawyers Lemons? Competition Principles and Professional Regulation* St James Ethics Centre 2002 Lawyers' Lecture www.lawlink.nsw.gov.au/sc.nsf/pages/spigelman_041102

Like most professions, legal practice is characterised by a high degree of information asymmetry. The client comes to the professional precisely because he or she is out of his or her depth in dealing with a particular problem. The client's ignorance of the subject matter both necessitates the services of the professional and requires a high degree of trust that the services provided will in fact address the problem. An unsophisticated client simply doesn't have the information to evaluate what he or she is buying. Time based billing, with its readily understandable metrics, appears to overcome some of this asymmetry by providing a familiar yardstick. The apparent objectivity of that yardstick, rather than the subjectivity of concepts like "value", and the fact that it operates in the same way regardless of the subject matter of the work, make it very attractive.

More generally, time billing provides a readily accessible audit trail if there is a need to investigate "exactly what the practitioner did to justify payment".³⁰

The information asymmetry problem is less acute for sophisticated, generally corporate, clients for whom time billing is convenient because it can be made comparatively easily to fit into expenditure monitoring systems, and can readily be automated to produce formal reporting documents.³¹

From the point of view of the lawyer, time based billing provides an extremely low-risk operating environment. Income is solely dependent on, and can be predicted from, the hours worked. The risks of success or failure, or partial outcomes, lies with the client unless the client is able to negotiate an alternative.

The more indirect effects of time billing are not so simple.

Time billing is essentially a cost-plus pricing mechanism – as costs increase you simply increase the price, until customer resistance forces a change. The high levels of overhead costs reflected in the information supplied by the Law Society and set out in Figure 1 in Section 1.3 above may well illustrate this. Over time, the ability to increase prices directly in proportion to increased costs, and or increased profit expectations, diminished and firms reacted by increasing the number of hours billed by each lawyer. Billable hour goals and guidelines became billable hour requirements and budgets, and increased over time.³²

The economics of legal practice changed significantly in response to time billing. Previously legal clerks and junior lawyers were overhead costs of a firm. With the advent of time pricing their inputs could be easily measured

³⁰ Bill Madden, *Slater & Gordon Submission to the Legal Fees Review Panel*, para 15

³¹ North Carolina Bar Association Alternative Billing Commission, *Final Report & Recommendations*]; See also Jeremy Holmes, *Hourly Billing: A Guide for Law Students* Economics of Law Practice Seminar, University of Iowa www.uiowa.edu/~cyberlaw/elp99/holmesj.html

³² ABA, *Billable Hours Report* p 3

and on-billed to clients, with room for a profit component as well. Their salaries went from being overhead costs to opportunities for leveraged profit. Accordingly, incentives to keep these salaries low disappeared, with a resulting inflationary effect on law firm fees over time, as highly paid juniors expected to become more highly paid seniors, and in turn even more highly remunerated partners.³³

In the late 1980's and 1990's, criticism of the effects of time based pricing began to emerge in the United States and spread to Australia and other parts of the common law world. One commentator even referred to it as "a devilish creature that rewards inefficiency and penalizes productivity".³⁴

There is now an extensive body of literature canvassing the problems of time billing, and much of this was canvassed in detail in the Discussion Paper. The following is a list of the most common and salient criticisms, many of which are inherent in the conceptual framework of time based pricing.

- Time based charging privileges quantity over quality. It rewards best those who take longest, regardless of what they produce.
- It allocates all major risk to the client.
- It discourages, by not rewarding, non-chargeable uses of time- such as education, community contributions, professional activities and perhaps most importantly of all, the active and detailed supervision of junior staff.
- It encourages increasing billable hours targets, since this is the easiest way to boost profits without encountering client resistance.
- It provides no incentive for speed or efficiency and arguably actively discourages both.
- It puts the client's interest in a swift and efficient resolution directly in opposition to the lawyer's interest in maximising hours and therefore income.
- It is unaffected by success, and therefore not conducive to improvement and excellence.

Time billing also distances lawyers from any understanding of the real market value of their services. Anecdotal evidence suggests that most firms determine their hourly rates simply by comparing the rates charged by peers and pitching their own at a level seen to be competitive with them but consistent with the partners' desired image and income levels. It is highly

³³ Kenneth Roberts "The Hourly Fee System is a 'Devilish Creature'" in Reed *op cit* , pp 35-36.

³⁴ *ibid.*

likely that the observations of US lawyer Mary Ann Altmann, made in 1989, are essentially still true of most Australian lawyers today, particularly those in smaller and less commercial practices:

Most lawyers really do not know the cost of the legal services they sell. Hourly rates, today, basically are billing rates based on competitive positions. The process of annually reviewing hourly rates generally involves securing information on what other lawyers are charging rather than how the cost of operating the firm has increased.³⁵

In Australia Mr Justice Kirby noted in *Law Society of New South Wales v. Foreman*: “time charges have a distinct potential to result in overcharging”.³⁶ The opinions of Chief Justices Spigelman and Gleeson, to the effect that it is unsustainable and rewards inefficiency, have already been mentioned.

Time based pricing has significant effects on the health, happiness and ultimately the effectiveness of lawyers, with obvious consequences for consumers and the value they receive for their hourly rates. In its contribution to practitioner burn-out it also has the potential to undermine the overall quality of the profession.

Messrs Cutler and Cameron, on behalf of the large firms, submitted in response to the Discussion Paper that the differences in billing systems and regulatory regimes between Australia and the United States are such that “there is no justification for any conclusion, or assertion, that the experience of those firms would be reflective of what happens in New South Wales.”³⁷

In the United States, Yale Law School’s Career Development Office has published a document entitled *The Truth About the Billable Hour* which it provides to students considering careers in private practice.³⁸ In it the Career Development Office calculates the impact of several different billable hours budgets on the life of a lawyer, demonstrating the amount of time needed to achieve the targets. The differences between the various levels of time budget are merely matters of degree, as would be any differences between budgets as applied in the United States and those applied in New South Wales. None of the issues of time taken for meals, professional development, personal hygiene, commuting or internal firm activities have any connection to, or are significantly affected by, the regulatory regime in which the billable hours budget operates. Since no allowance is made for time written off in the calculations, it is hard to see how different billing practices could impact either. The impacts of lack of time and overwork, with consequent personal and professional damage noted by Yale are precisely those raised by the Young

³⁵ Mary Ann Altman, “A Perspective – From Value Billing to Time Billing and Back to Value Billing”, Reed *op.cit* p 11

³⁶ (1994) 34 NSWLR 408 at 422 –433

³⁷ Cutler & Cameron, *Submission to the Discussion Paper*, p 2

³⁸ www.law.yale.edu/outside/html/Career_Development/cdo-billable.html

Lawyers' Section of the Law Society of New South Wales in their response to the Discussion Paper:

The current emphasis on billable hours means that junior lawyers in private practice and employee solicitors are often burdened with the highest budgets and have the least amount of control over the final bills. This has significant consequences in terms of lifestyle and retention rates in the profession. Further it also discourages senior practitioners from devoting time and resources to the training of new practitioners.³⁹

On 1 April 2004, the *Australian Financial Review* quoted the then-current President of New South Wales Young Lawyers, Nathan Laird, saying

Long hours are the norm in the bigger firms. A lot of young lawyers regularly work until 10.00pm or midnight, and working weekends is standard.

Mr Laird observed that the complaints are widespread and Katherine Sampson, managing director of the legal recruiting firm Mahlab's, observed that:

Ten years ago the juniors were flogged. Now it's everybody. We still see partners who have not had dinner with their wife, husband, friends, for months.⁴⁰

These complaints directly mirror those reported in the United States.⁴¹

Time billing may also systemically drive and support increasing legal costs.

It has been posited that increasing legal costs are driven systemically by the economic structure in which they are provided. The American economist William Baumol noted in 1965 that where output per labour hour is constant in an economic sector (as it is when time is the basis of pricing – an hour cannot be expanded) employment in that sector will rise, but so will the cost of provision of the services. The result is that, unless ways are found to improve labour productivity, average costs will continue to rise, as will prices if they are directly based on hourly costs.⁴³

³⁹ Philippe Gray-Grzeszkiewicz and Davyd Wong, *NSW Young Lawyers Submission to the Legal Fees Review Panel*, covering letter

⁴⁰ Lucinda Schmidt, "The Perils of Young Guns Dying to Be Lawyers" *Australian Financial Review* 1 April 2004, p1

⁴¹ See for example, Dennis Curtis & Judith Resnik, "Teaching Billing: Metrics of Value in Law Firms and Law Schools" 54 *Stanford Law Review* 1409, 1412

⁴² John Walker, *IMF (Australia) Ltd Submission to the Legal Fees Review Panel*, p 7.

⁴³ William Baumol, "On the Performing Arts: The anatomy of their economic problem" *American Economic Review* 55 (2) pp 495-502 May 1965; cited in Robert E. Marks, "Rising Legal Costs", *Justice in the Twenty First Century* Chapter 15 Russell Fox (ed.) Cavendish, London 1999

William C. Cobb has observed that the relative value of legal services forms a curve when graphed against the volume of work available to a firm. Put simply, the higher the available volume, the more price sensitive is the work. Thus, alternative pricing mechanisms are most likely to impact, at least initially, on high volume work areas, like mortgage discharges and standard form loan documentation work.⁴⁴ Volume work is more like a commodity and may be more effectively priced as such, using such mechanisms as fixed fees. On the other hand, some work requires experience and expertise and has unique characteristics. This renders the inherent risks much less predictable, and the work much more susceptible to variable pricing mechanisms such as hourly rates, with or without other features such as premiums or caps.

This commoditisation process may well be underway, as indicated by the Hildebrandt research discussed above.⁴⁵

1.6 Other significant contributors to costs

It is neither fair nor accurate to attribute all the blame for the rising cost of access to legal services to the fees charged by lawyers, whether priced according to time or otherwise.

In contested matters, court practices contribute significantly to legal costs.

The Legal Profession Advisory Council, in its response to the Discussion Paper, has commented that:

excessively high costs in litigation are not merely the result of lawyers' fees and or specific billing practices but rather arise as a result of an amalgam of enshrined practices throughout the litigation process. These costs are shared across a range of legal and non-legal services including for example cost associated with subpoenas, expert witnesses, expert reports, discovery procedures and court filing fees.⁴⁶

Mr John Marsden, former President of the Law Society of New South Wales observed:

The costs of legal fees have been substantially increased not by the lawyers, not by hourly rates, not by anything but the total and absolute outrageousness of Court management rules.

⁴⁴ William C. Cobb, "The Value Curve and the Folly of Billing-Rate Pricing" Reed *op cit.* p17

⁴⁵ Hildebrandt Inc, *op.cit.*

⁴⁶ Vernon Winley, *Legal Profession Advisory Council Submission to the Legal Fees Review Panel*, p 2.

It is better to have a solicitor sit around a Court waiting for a matter to come on until 4.00pm and then get a not reached made than to have the Court fall over at 2.30pm and not have anything to do from 2.30pm to 4.00pm. That is the attitude and that adds to the costs.⁴⁷

Chief Justice Spigelman also acknowledged in his Opening of Law Term address that case management strategies might in fact have increased costs.⁴⁸

The different tax treatment of individuals and corporations generates significant inequities and particularly supports the continuation of high litigation costs.

Corporations can claim most if not all of their legal costs as tax deductions, whereas no such deduction is generally available to individuals. Further, since corporations will usually be registered for GST, they are also able to claim the GST on their legal bills as offsets against their own GST liabilities. The non-commercial litigant on the other hand is required to bear the full burden of the GST.

While the cost of legal advice is a significant curb on the activities of individuals and small businesses there is much less incentive for larger corporations and businesses to reduce expenditure in this area, with the only real danger area being potential cash flow impact. On the other hand, there is anecdotal evidence of the use of litigation costs as a strategy, promoting what the Australian Lawyers Alliance has referred to as “dilatory and spurious legal machinations” which constitute a “war of attrition” against less well-off, non-corporate opponents.⁴⁹

Arguably, the combined effect of the unequal availability of tax deductions and GST offset is a taxpayer subsidy for commercial litigation.⁵⁰ Individual litigants, often sufferers of catastrophic personal injuries and with very limited means, effectively subsidise commercial litigation undertaken on a “Rolls Royce” scale.

Such practices may well be inherent in adversarial litigation, particularly as it is practised in Australia. Mr Justice Davies of the Queensland Court of Appeal has commented that our procedural systems place an undue emphasis on:

the adversarial imperative: the compulsion which the system produces in each party to see the other as the enemy who must be defeated. This in

⁴⁷ John Marsden, *Submission to the Legal Fees Review Panel*, p1

⁴⁸ Justice J. Spigelman, *Opening of Law Term Dinner Speech 2004*

⁴⁹ Australian Lawyers Alliance submission to Legal Fees Review Panel Discussion paper, p 12

⁵⁰ See Cameron Murphy, “Tax Deductibility and Litigation: Reducing the Impact of Legal Fees and Improving Access to the System” (2004) 27 *UNSWLJ* 1 at 240

turn results in litigation being conducted on the basis that “no stone should be left unturned”. And if you leave one unturned, then your opponent, who doesn’t, may win. And if your solicitor advises you to leave one unturned, and is later proved wrong, then you may sue him or her.⁵¹

In 1992, in a study conducted for the Australian Institute of Judicial Administration, Phillip L. Williams and Ross A. Williams concluded that the major influence on the cost of litigation in intermediate courts was the stage at which the matter settled. For example, in Victoria, a case that went to trial cost on average four times as much as a case which settled at pre-trial conference.⁵² There was little evidence that the greater use of senior staff in the early stages aided settlement, but considerable evidence that the more experienced the firm in the area of litigation, the lower the costs.⁵³

The Williams’ study also revealed that one of the major contributors to the cost of litigation was the surprisingly high cost of expert reports, with the costs of such material occasionally exceeding the legal costs. Like lawyers, most expert witnesses charge by the hour, and examination of complex material can easily generate fees on par with or in excess of the lawyers’ fees. Practitioners often cite anecdotal evidence of report and attendance fees from experts such as forensic accountants, consulting engineers and medical consultants which range into the hundreds of thousands of dollars, especially where cases revolve around complex battles of competing expert opinions. The Williams’ recommended rules limiting the number and use of external experts, particularly in cases relating to personal injuries, as a way to reduce litigation costs.⁵⁴ They also noted that:

changes to procedures that would more closely involve the client in the litigation process would help plaintiffs to gain a better understanding of the process of litigation and of what ought to be expected of a reasonably efficient solicitor.⁵⁵

1.7 Developing a framework for response

The cost of legal services is a perennial concern because it is a perennial problem, inherent in the information asymmetry characteristic of any profession and the practice of law. It is likely that some level of concern will always be with us and that, as a community, we will always need to be vigilant to preserve a favourable social cost-benefit balance. This means continually

⁵¹ Davies, *op.cit.* at 203

⁵² Philip L. Williams & Ross A. Williams, “The Cost of Civil Litigation: An Empirical Study” 14 *International Review of Law & Economics* 73 at 83

⁵³ *ibid.*

⁵⁴ *ibid* p 85

⁵⁵ *ibid*

adapting our community responses to the different ways in which the problem manifests over time.

Consumers of legal services are a very diverse group with significant differences in experience and degrees of market power. The difficulties faced by those at the top end of the market, although at times similar, are sufficiently distant from those encountered by “retail” customers as to require different responses, if only because “retail” customers lack the market clout to be able to arrange their own solutions.

The breadth of this differential means that a tightly prescriptive or proscriptive policy response is unlikely to be helpful. The desirability of encouraging the profession and its customers to develop and adopt alternatives to time based billing is clear. What is less clear is what those alternatives are and whether any one of them would be any more applicable as a “one size fits all solution” than is the current approach. In any event, it is likely that, once alternative approaches come to be better understood, the competitive nature of the legal services market will itself drive demand for them and encourage their further development. The already high level of regulation of the legal profession in New South Wales is also of concern, and the democratic desirability of permitting commercial operations to decide their own pricing structures must also be recognised.

It is also clear that increased communication between client and lawyer must be central to any strategy aimed at reducing the price of legal services. Regardless of the pricing mechanism, a client who understands what is involved and is able to negotiate and monitor the process is much more likely to feel in control of the costs and satisfied with the outcome.

As both Slater & Gordon and the Australian Lawyers’ Alliance point out in their responses to the Discussion Paper, “to simply be critical of time billing or similar mechanisms for costing legal services is not sufficient in the absence of a viable alternative”.⁵⁶ Viable alternatives do not spring fully fledged from the ether, or from the legislative draftsman’s office. Like the development of time billing, they evolve through iterative processes as the profession and its clients react to market and other pressures and experiment with what is available to them.

At the heart of the matter are questions of the allocation of financial risk and the creation and management of expectations. Except for the most mundane and mechanical of legal work, all legal matters have an element of contingency in them requiring the care, skill and judgement of the professional to be exercised. This is precisely why the lay client comes to the professional adviser. Inherent in this exercise is professional judgement, a concept which necessarily implies a chance that the professional judgement will not be right or will not be successful, i.e. a risk, to be allocated or distributed between lawyer and client.

⁵⁶ Madden, *Slater & Gordon Submission*, para 17; Australian Lawyers’ Alliance, *Submission to the Legal Fees Review Panel*, p. 13

From consideration of matters raised in the Discussion Paper and submissions in response to it, it appears that concern about the level of legal fees stems from three main points:

- The use of time as the universal pricing mechanism; and
- The consequent unbalanced allocation of risk between lawyer and client, both of which are supported by:
- A lack of communication and negotiation between lawyers and their clients sufficient to ensure that each clearly understands and agrees to:
 - the fees to be charged for legal work,
 - the work to be undertaken to justify the fees and
 - the role of risk in their professional relationship.

Time records are, and are likely to remain, an important management tool for any law firm. Criticism of their use as a pricing tool has been well underway for more than a decade but they continue to dominate legal pricing in the common law world. On the other hand, this dominance also took decades to achieve. Richard Reed, one of the pre-eminent American advocates of a movement away from time based pricing puts the slow pace of change down to inertia, and fear of the unknown.⁵⁷ It may also have to do with the demonstrated benefits and ease of use of time billing, and the lack of widespread understanding and evidence for the success of alternative methods.

A responsive policy framework must address the following needs:

- It must provide stability and facilitate the continued effective operation of the majority of legal practices who appear to be pricing their services ethically and properly, to the satisfaction of their clients. This means that it must:
 - accommodate, at least in the short to medium term, the continued dominance of time based pricing while encouraging a move away from it; and
 - be clear in what it requires practitioners to do and what it entitles clients to require.
- It must encourage industry wide movement to pricing mechanisms which are less inclined to drive and entrench higher prices for access to legal

⁵⁷ "Not Snow, Nor Sleet, Nor Gadget Boom Will Kill the Billable Hour" *National Law Journal* 31.8.98 www.wendytech.com/articlesbillablehour.htm

services.

- It must facilitate increased negotiation and communication between client and solicitor in relation to pricing mechanisms.
- It must facilitate the market based development of a range of alternative pricing mechanisms, which respond to the diverse needs of a broad range of clients.
- It must be transparent.
- It must respect the autonomy of practitioners and the profession as far as possible and allow them to react effectively to the competitive environment in which they operate.
- It must facilitate and encourage increased responsiveness by practitioners to the pricing and communication needs of their particular clients.
- It must facilitate an improvement in the negotiating position of less sophisticated clients without unduly constraining or frustrating sophisticated users of legal services and their lawyers.
- It must not dramatically increase the regulatory burden on the state, and should over time reduce complaints about legal practitioners' charging.
- It must not in itself contribute to increased costs.

2. OUTLINE FRAMEWORK OF PROPOSED POLICY RESPONSE

Any lasting change to the way in which legal fees are charged will require time, and many iterations by consumers and service providers rather than exclusively by regulators. While recognising its centrality in the short to medium term, the proposals in this paper represent an attempt to foster a movement away from the current dependence on time billing as the dominant pricing tool for the legal profession.

There is a difficult balance to be struck in addressing these issues.

It is true that the legal profession is heavily regulated, particularly in relation to its fees and charges, and that this is a point of particular sensitivity for practitioners. This sensitivity is evident from the responses received to the Discussion Paper.

The Costs Working Group of the Law Society of New South Wales commented that:

the legal profession is the most regulated profession in the country and especially in New South Wales. Accountants, architects, engineers and other professionals as well as tradespersons do not have imposed on

them such stringent provisions in order to be paid a fair and reasonable fee for services rendered.⁵⁸

The former president of the Law Society, Mr John Marsden, observed:

I don't want to, and neither do my Partners want to, have more and more regulations, more and more requirements or whatever to run our legal practice.⁵⁹

Slater and Gordon point to the difficulty of constructing appropriate "one size fits all" regulation:

it is difficult to visualise a regulatory regime which would take into account the myriad of situations and client needs that can and do arise.⁶⁰

The views from the other side of the desk are often just as passionate, and much less comfortable with the status quo. Submissions received by the panel referred to matters where estates were largely eaten up with legal costs,⁶¹ or litigation costs escalated to well beyond the total amounts in dispute⁶². LawConsumers Inc says "the legal profession is a monopoly in which the state has abdicated control".⁶⁴

An objective statement of the true position is unlikely to be found. However it is clear from the earlier discussion that the cost of accessing legal services is unlikely to fall unless the overall system both provides incentive for improvements in productivity and passes on the benefits of such improvements. A movement away from purely time based billing is critical to such developments, and time billing has shown itself to be particularly intransigent. It is unlikely that change will occur in the short to medium term without further regulatory intervention.

This paper proposes interventions more focussed on facilitating industry level cultural change than on detailed regulation of conduct. Changes are proposed where they are seen to be necessary either to provide appropriate answers to identified problems or where they will drive new approaches to charging and billing and enhanced practitioner client communication.

⁵⁸ Law Society of New South Wales, *Costs Working Group Submission to the Legal Fees Review Panel*, p 1

⁵⁹ Marsden, *Submission*, p 2

⁶⁰ Madden, *Slater & Gordon Submission*, p 3

⁶¹ Ashton Johnson, *Submission to the Legal Fees Review Panel*

⁶² Margaret Penhall-Jones, *Submission to the Legal Fees Review Panel*

⁶³ Walker, *IMF (Australia) Ltd Submission to the Legal Fees Review Panel*, p 2

⁶⁴ Max Burgess, LawConsumers Inc, *Submission to the Legal Fees Review Panel*, p 1

In summary form, this is a multi-layered approach involving the following steps.

In the short to medium term:

- Recognising that time billing will, at least for the time being, remain central to lawyers' pricing.
- Making alterations to the disclosure and billing regimes to better protect the consumer and improve transparency in costing and billing:
 - Extending the disclosures required at or around the time the lawyer is retained
 - Eliminating the opportunity for profit on disbursements;
 - Requiring regular billing, and the provision of specific rights information with bills.
- Introducing the concept of individual matter budgeting as an alternative to the standard disclosure process, to encourage a movement towards risk sharing and alternative fee structures (see discussion in Section 6 below).
- Introducing limits on the amount of costs which can be awarded to non-compliant lawyers when no, or insufficient, disclosure is made.

In the medium to long term:

- Encouraging the adoption and spread of budgeting through appropriate consumer and professional education and information.
- Using budgeting to support development of alternative approaches to pricing legal services.
- Supporting the development of a more mature market for legal services by improving the information available to the market.
- Establishing a research capability to examine the economics of the legal profession in New South Wales, with an initial brief to address the range of fees actually charged in New South Wales and the means by which they are determined.
- Supporting changes in the economic structure of the legal services market to better reward improved productivity and sound management, and present an opportunity for overall lowering of legal costs.

- Using the results of research to generate debate and changed practices, both in the profession and in the academic and practical training of lawyers.

3. DISCLOSURE REQUIREMENTS

Lay clients presented with large amounts of material at the time of retaining a lawyer are unlikely to retain a great deal of it. It is therefore important that they are easily able to access the material later, and that they are reminded at critical times of the need to do so. Clear summary information, in a form which can serve as an easily accessible reference, is the key to effective disclosure.

The compulsory disclosure of fees at the time a legal practitioner is retained was introduced in 1994, by way of amendment to the *Legal Profession Act 1987* (“the 1987 Act”). In the ten years since its introduction, New South Wales lawyers have generally embraced the disclosure regime. Indeed some have realised that the disclosure process provides them with an opportunity to “sell” their services, and the quality of those services, to their clients.

The philosophy behind the regime is that transparency facilitates increased control for clients, and better communication between practitioner and client. It recognises the importance of bringing issues of cost and risk to the fore, because at the time of engagement the client is usually focussed more on the outcome than on the process by which it is to be achieved.

There will always be a difficulty with disclosure for small-scale, “retail” clients, particularly those who suffer from some form of social or educational disadvantage. There is a limit on the extent to which inherently complex material can be simplified without distortion of meaning, and no statutory amendment can improve this situation.

3.1 Requirements of the Legal Profession Act 2004

The 1987 Act has now been replaced by the *Legal Profession Act 2004* (“the 2004 Act”), which has been drafted to comply with national model laws, and which commenced on 1 October 2005. Compared to the 1987 Act, it requires disclosure of a significantly expanded number of matters (Section 309).

Disclosure must now include:

- The basis upon which costs will be calculated, including fixed costs;
- The right to negotiate a costs agreement and receive a bill;
- The right to provision of an itemised bill on request;

- The right to notification of substantial change to the matters disclosed;
- An estimate of the total legal costs or a range of estimates along with major variables that may affect the costs;
- The intervals at which the client will be billed;
- The rate of interest to be charged on outstanding costs;
- An estimate of the costs that may be recovered if successful in litigation;
- The range of costs that may be paid on an adverse costs order if unsuccessful;
- The right to progress reports on request;
- Details of the contact person with whom to discuss costs;
- Avenues available in the event of a costs dispute, and the applicable time limits;
- A statement that solicitor/client costs may exceed party/party costs;
- A statement that disbursements may be payable on a conditional costs agreement;
- Details of any uplift fee, if permitted.

The requirement to provide not only an initial estimate of total costs (as required by Section 177 of the 1987 Act) but also a range of estimates and an explanation of the variables on which they depend is a significant expansion of the estimate requirements. Such material contributes greatly to a client's ability to understand the range of likely outcomes which may result from his or her instructions.

The exemptions from disclosure contained in the Solicitors' Rules (Rule 1) and Barristers' Rules (Rule 114) are now also set out in more detail in the body of the Act, in Section 312. In summary, these include:

- matters where the total legal costs exclusive of disbursements are unlikely to exceed \$750, (s.312 (1)(a));
- where the client has already received disclosure in the previous 12 months and a principal of the law firm decides on reasonable grounds that further disclosure is not warranted (s.312 (1)(b));
- where a sophisticated client such as another law practice, public company or government agency is involved (s312(1)(c));

- where the costs have been determined by tender process or where the costs will not be recovered by the law practice (ss312 (1) (c) & (d))

Where one practitioner (for example, a barrister) is retained by another practitioner (for example, a solicitor), the obligation to disclose to the instructing practitioner is expressed in Section 310. The 2004 Act extends this obligation to require the instructing practitioner to provide the substance of that disclosure to the client (Section 310 (1)).

Disclosure is required to be made in writing, as it was previously, but may be made orally in circumstances of urgency, to be followed by written confirmation as soon as practicable (Section 311).

Section 318 now requires a practitioner to provide written progress reports on request from a client, and permits the practitioner to charge for doing so.

This expanded disclosure is a significant improvement. A client in receipt of this information is in a much better position to evaluate the likely effects of his or her instructions than is the case under the current Act. However, a number of areas of difficulty remain and could profitably be addressed.

3.2 Form of disclosure

Section 179(2) of the 1987 Act provided that disclosure may be made separately, or in a costs agreement, or any other contract relating to the provision of the legal services in question. There is no directly correlative provision in the 2004 Act, nor does it provide that disclosure needs to be made separately.

For clients with small amounts of legal work, and most individual rather than corporate clients, costs agreements are often experienced as an uneven bargain where the client has little leverage other than going to another solicitor who will confront him or her with another version of a very similar agreement. Urgency particularly impedes both the ability to negotiate and the ability properly to comprehend information about matters, such as costs, which at the time seem peripheral but which later assume far greater significance.

The impact is graphically illustrated in John Marsden's submission in response to the Discussion Paper:

The lady that comes in here for shoplifting and pays off her fees at \$20 a fortnight, she doesn't want a Costs Agreement. She doesn't want to be told every week about it. She doesn't want all these rules. She just gets terribly confused when she gets a Costs Agreement and on some occasions they break down in tears when you put a Costs Agreement across the desk and ask them to sign it.⁶⁵

⁶⁵ Marsden, *Submission*, p2

Properly addressing this issue requires education and the provision of accessible market information (see discussion in Appendix A) but the problem is exacerbated if the compulsorily disclosed information is not readily accessible when the client does realise a need to refer to it. A number of submissions from non-practitioners refer to the stress of reading and understanding costs agreements, especially those which use language that is seen to be opaque and jargon filled. Compulsory disclosures embedded in such documents are essentially inaccessible to some clients. On the other hand, increasing the number of documents to be provided would also contribute to confusion and opportunities for misunderstanding.

One possible solution to the problem of the form of disclosure might be to require the compulsory disclosures to be provided as an annexure to any costs agreement. This would ensure that the compulsory information is readily found and not “buried in the detail”.

The Costs Working Group of the Law Society has drafted a set of preliminary precedents for standard costs disclosures and costs agreements. These are structured so that the costs disclosure is provided in a separate document to any agreement about fees and the terms of the lawyer’s retainer. In the panel’s view, this is the most appropriate approach to the provision of statutory disclosure. Copies of these precedents are available free to all members of the Law Society, from the society’s website, www.lawsociety.com.au.

Recommendation

- 1. Where compulsory disclosures are included in a costs agreement or other contract between a practitioner and a client, they should be required to be set out in a separate schedule or annexure.**

The effective operation of the 2004 Act may be enhanced by taking up a number of further options for improved disclosure processes. These include expanding the material required to be disclosed to include matters such as:

- the circumstances under which a practitioner may transfer money from the firm’s trust account to the general office account;
- the difference between solicitor/client costs and party/party costs;
- the means by which party/party costs can be recovered; and
- the practitioner’s rights over the file if fees are not paid.

A useful solution would be to adopt a procedure along the lines of one now required by the Family Court. Rule 19.03 of the Family Court Rules requires a court approved “Costs Notice” brochure to be provided to each client at the time of retainer. The notice is essentially a statement of the client’s rights,

including rights to an assessment of costs, and costs agreements may not be inconsistent with it. It serves as a useful summary reference for the client, and this utility is reinforced by the requirement that each bill must refer to the costs notice, drawing it to the client's attention again. The standard form is also convenient from the practitioner's point of view as it ensures that compliant information is provided to each client.

Requiring such a standard form "rights notice" would ensure appropriate simplicity of language, and the notice could also be drafted to provide the information about costs assessments and complaints which is not included in the compulsory disclosures required under the 2004 Act. Rights notices should be provided to all clients, with a possible exception for public companies and government instrumentalities.

Recommendation

- 2. Practitioners should be required to provide a standard form rights notice to all clients at the time of retainer, other than clients which are public companies or government instrumentalities.**
- 3. The rights notice should include at least:**
 - a. A statement of the client's right to receive bills;**
 - b. A statement of the client's rights to have bills assessed;**
 - c. A statement of the circumstances under which a solicitor may transfer moneys held in trust to the solicitor's office account;**
 - d. Explanations of the terms "disbursement", "party/party costs" and "solicitor/client costs";**
 - e. Details of how party/party costs may be recovered;**
 - f. A summary of the practitioner's rights, including the right to exercise a lien, if bills are not paid.**

3.4 Disbursements

Charges for disbursements appear to be particularly irritating to consumers. They are the subject of many complaints to the OLSC, and are referred to in the submissions received from consumers in response to the Discussion Paper. The following is a typical comment:

If I can photocopy something at Kinko's for 9c a page, why should I be charged 30c or up to \$2 a page? ⁶⁶

The Costs Assessors' Rules Committee notes that assessors regularly reduce disbursements claimed by practitioners, and states that it

would support reforms which would eliminate profiteering in relation to disbursements which may not be true disbursements (i.e. disbursements ordinarily included in overheads.) ⁶⁷

The Oxford English Dictionary defines the term "disbursement" as "money paid out; expenditure". The word is an archaic one, originating in the fifteenth century and in common usage in the nineteenth. Nowadays it is used almost solely by lawyers. It is therefore an unfamiliar term to most clients, who see it as confusing and whose confusion is increased by changes in legal usage in (etymologically) recent times.

As can be seen from the dictionary definition, the term originally applied to payments made to third parties on a client's behalf: out of pocket expenses, which the lawyer recouped from his principal just as any other agent would. It encompassed court fees, taxes, duties, charges, counsel's fees and the like. The lawyer charged separately for these things because he charged for his own work on an item-by-item basis, and would be out of pocket if the expense were not recovered. Disbursements properly called have to be distinguished from general office overheads that cannot be identified as having been paid on behalf of a particular client.

Time costing, however, was introduced as "an hourly rate which covers overheads of the practice as well as the need for appropriate remuneration for partners." ⁶⁸ Overheads such as copying, typing, clerical and other services were originally included in the charge, but as firm administration costs increased (particularly with office computerisation and the availability of photocopying) the practice emerged of treating such charges as disbursements rather than increasing lawyers' hourly rates. In many cases, the traditional "third party payee" role was assumed by a service company owned and operated by members of the partnership or their associates, or for their benefit. (There were of course other, and possibly stronger, tax and estate management motivations for such structures.)

The Law Society is of the view that "disbursements is a generic term and includes all charges", a very wide departure from its dictionary and original meanings. ⁶⁹

⁶⁶ Penhall-Jones, *Submission*, p5

⁶⁷ Robert Benjamin, *Costs Assessors' Rules Committee Submission to the Legal Fees Review Panel* p 3.

⁶⁸ GE Dal Pont, *Lawyers' Professional Responsibility in Australia and New Zealand* 2nd Ed LBC 2001 p 394

⁶⁹ Law Society, *Submission*, p 5

Regardless of origin, lawyers' bills commonly refer to "disbursements" which involve a widely varied array of charges paid either internally to the firm or to a related entity.

A particular problem arises when these "overhead" disbursements or service charges are provided at a profit, becoming in their own right income generating centres of the lawyer's business. Photocopying charges are of particular concern, and often feature in complaints to the OLSC from clients who are dismayed at the high volume of copying and consequent charges that have been incurred without any consultation with them. The Law Society supports the proposition that a distinction must be drawn between "disbursements proper which are to be paid to third parties" and "ancillary charges which include a profit element." It is of the view that

if those charges are separately set out in the disclosure document or costs agreement and explained to the client, there has been full disclosure.⁷⁰

This position appears to assume that disclosure, and presumably a consequently informed consent, defines the extent of the lawyer's duty in these circumstances. There are other views.

The new editor of the *New South Wales Solicitors' Manual*, Professor Gino Dal Pont, characterises the fiduciary nature of the lawyer client relationship thus:

a lawyer must, because of her or his status as a fiduciary, shun situations involving a conflict of interest between the lawyer's personal interest and her or his duty to the client, and refrain from using the lawyer-client relationship in order to profit apart from a reasonable professional fee.⁷¹

The personal interest of any lawyer who has a direct or indirect interest in a business providing ancillary services at a profit lies in maximising the use of those services, and, on this analysis, this is clearly inimical to the relationship of trust which should exist between lawyer and client. Mere disclosure, particularly in the fraught circumstances in which clients often engage lawyers and considering the power differential in the relationship, would not be sufficient to redress a breach of such a fundamental duty.

Arguably it is already forbidden as a breach of fiduciary duty, but the number of anecdotal references to such practices is sufficiently high that it is desirable to put the matter beyond doubt.

One available approach is to require legal practitioners to absorb all disbursements less than a specific threshold into their hourly rates. An

⁷⁰ Law Society of New South Wales, *Costs Working Group Submission to Legal Fees Review Panel*, p 5

⁷¹ *ibid.* p 149

indicative threshold might for example be \$1000. This approach presents several difficulties. It is likely to drive up hourly rates, and consumers are unlikely to perceive the corresponding benefit (if any) of a reduction in disbursements. Firms would still need to keep records of disbursements, and in a large matter the threshold would be quickly reached, with the result that the old problem of large disbursement bills is likely to recur. Applying the threshold on a “per billing cycle” basis may lead to distortions in periodic billing, such as withholding bills until the amount exceeds the threshold so that the cost may be passed on.

A second option may be to require that all disbursements other than genuine payments to independent third parties be absorbed by the legal practitioner. This also is likely to increase hourly rates, but is unlikely to cause billing delays. The principal difficulty with this option is the evaluation of what constitutes an applicable disbursement. Careful drafting will be required to prevent it from protecting arm’s length service companies which are nevertheless ultimately related in some way to the legal practitioner or his or her firm.

A third option is to introduce a requirement that, where ancillary services are to be charged separately from a firm’s hourly rate, the firm should be required to disclose to the client the identity of the proposed service provider and a concise, plain English explanation of any relationship between the service provider and the principals of the firm.

Neither practitioners, their firms nor entities in which they have an interest (directly or indirectly) should be permitted to charge more than cost for such services.

Recommendations

- 4. A practitioner should be required to disclose to a client the existence and nature of any relationship between the practitioner, the practitioner’s firm or any member of the practitioner’s firm and any service provider proposed to be retained to provide services for which the client will be charged.**
- 5. No practitioner, or practitioner’s firm, should be permitted directly or indirectly to make a profit on disbursements.**
- 6. Practitioners should not be permitted to charge separately for disbursements in the nature of overheads: i.e. other than payments to independent third parties unrelated to the practitioner or any member of his or her firm.**

3.5 Retention of third party experts

The Discussion Paper raised the issue of the management of third party experts, including barristers.

Complainants to the OLSC express surprise at the amount of such charges, and research has indicated that the cost of expert reports is a significant expense which can even exceed the legal costs.⁷² LawConsumers Inc, in their response to the Discussion Paper, comment that:

Consumers of legal services are most concerned at the high costs of disbursements. To them it appears that solicitors have no regard for the amount of money that is spent on behalf of their client without their knowledge or consent.⁷³

Section 310(2) of the 2004 Act requires (as did s.176 of the 1987 Act) that a practitioner (eg a barrister) retained by another practitioner (eg a solicitor) on behalf of a client, must provide the statutory disclosures to the retaining practitioner. Previously the retaining practitioner was required only to disclose to the client the costs of the consultant practitioner (Section 175(3) of the 1994). Section 310(1) of the 2004 Act expands the required disclosure to include:

- The basis on which the legal costs will be calculated;
- An estimate of the total legal costs, or if this is not reasonably practicable, a range of estimates of the total legal costs and an explanation of the major variables;
- The intervals at which bills will be rendered;
- The rate of interest (if any) to be charged on overdue bills.

The disclosure supplied by the consultant practitioner is not actually required to be provided to the client, nor is any time frame specified within which the required details are to be passed on (other than general requirements for ongoing disclosure of matters likely to have significant impacts on costs estimates). There are no disclosure requirements in relation to non-legal experts and no requirement for disclosure of the likely costs of legal or non-legal experts before they are formally retained on the client's behalf. It is not difficult to understand how, even when the expanded disclosure requirements are met, clients might feel that significant costs exposures are beyond their control, particularly in litigious matters.

In an attempt to address this issue the Discussion Paper asked whether clients ought to contract directly with such experts, as this would put them in a direct relationship and enhance communication and control. There was very little support for this proposal from the submitters. Some pointed out that this would be a real burden to clients already stressed and distressed, particularly

⁷² Williams & Williams, *op.cit.* 85

⁷³ Burgess, *LawConsumers Inc Submission*, p4

if medical matters were involved.⁷⁴ Others noted that it would be cumbersome and would introduce further opportunities for delay.⁷⁵ The Law Society agrees with this position, except in the case of barristers, where it supports direct contracting with the client as a way of circumventing the difficulties its members encounter with recovering counsel's fees from clients.⁷⁶

As with many issues surrounding legal costs, communication appears to be at the heart of this problem, and all submitters supported increased information to, and participation by, clients in this area. In fact the difficulties identified by the Law Society in recovering barristers' fees (and other large external fees) may be reduced if clients were more fully engaged in the retainer process and felt more in control of the expenditures.

Particularly in litigious matters it is common to require expert opinion evidence from highly qualified professionals who, like lawyers, charge high hourly rates and who do not provide any of the disclosures or estimates required of lawyers. As has already been discussed, disbursements for such practitioners can match or even exceed the lawyers' fees, yet the client is often not an active participant in their selection or retention. Complainants to the OLSC are often surprised, and annoyed, by the apparent ease with which their lawyers spend their (the client's) money without consulting them. Except where urgency otherwise requires, there is no reason why the client should not be an informed participant in such decisions.

The Young Lawyers' Section point out that:

It is reasonable to expect the same amount of information about the billing practices of other professionals as it is with solicitors.

They recommended that Section 175(3) of the 1987 Act be expanded to require disclosure from all third party service providers whose expected costs will exceed \$1000 inclusive of GST. It is difficult to implement such a requirement simply through the regulation of lawyers: it is one thing to require lawyers to obtain such information, but quite another to require non-lawyers to provide it, and to do so in a timely fashion.

It would however be reasonable to require that, where a third party expert is required and is likely to charge more than \$1000, the retaining lawyer should inform the client of the likely cost and the expert's rates of charge and obtain the client's approval before retaining the expert. This could be done orally, with appropriate records kept by the lawyer.

⁷⁴ Penhall-Jones, *Submission*, p 5

⁷⁵ Madden, *Slater & Gordon Submission*, para 9
Australian Lawyers Alliance, *Submission*, p 7

⁷⁶ Law Society, *Submission*, p12

Recommendation

7. Where:

a practitioner proposes to retain a third party expert, other than another legal practitioner, on behalf of a client; and

the practitioner expects that that expert's fees will exceed \$1000; then the practitioner should be required to:

- obtain an estimate of the expert's fees;**
- provide that estimate to the client; and**
- obtain the client's consent prior to retaining the expert.**

An exception should be provided for urgent situations.

3.6 Barristers' cancellation fees

Another matter of concern to many clients, and some practitioners, is the practice of some members of the bar of charging cancellation fees when a matter set down for court hearing settles early.

From the perspective of the client, and public policy, the early settlement of a litigious matter is a positive outcome and should be encouraged. In reducing the savings to be made by settlement, cancellation fees operate as a disincentive to settle and may encourage continuation of matters which could otherwise be removed from the court lists.

A number of complainants to the OLSC object to paying cancellation fees because no work has been performed for the costs billed. Others are concerned that the practice is a form of double billing, whereby the practitioner is paid for the cancelled days and yet undertakes other work at that time, for which he or she is also paid.

From the barrister's point of view cancellation fees can be an important solvency protection. Barristers are required by the Barristers' Rules to work as sole practitioners and do not have the opportunities for cash flow management that solicitors operating in partnerships or employing other solicitors have. It is probably more accurate to regard the cancellation fee as a fee for having reserved the time of someone who could otherwise have accepted other opportunities to earn. As the Australian Lawyers' Alliance point out, other service providers such as doctors, hotels and travel providers routinely charge such fees. If there is no opportunity for compensation for turning away other work, it may be difficult to persuade barristers to take the risk of accepting briefs for long matters.⁷⁷

⁷⁷ Australian Lawyers' Alliance, *Submission*, p 10

Even viewed in this light it is still difficult to find a justification for the cancellation fee being calculated as all or most of the fees which would have been paid for the cancelled hearing and preparation. Few barristers would expect to be unoccupied for the entire period reserved for hearing or preparation of a matter which settles early, and double billing is a pernicious practice which should not be encouraged.

A cancellation fee is within the terms of the definition of “costs” in Section 302(1) of the 2004 Act (Section 3 of the 1987 Act), which reads “costs includes fees, charges, disbursements, expenses and remuneration”. As such, a barrister who proposes to charge a cancellation fee should disclose the fee, and/or the basis upon which it is to be calculated, to the instructing solicitor, (or in a direct brief, to the client), and the instructing solicitor should then disclose this information to the client. The experience of the OLSC is that this is not always done.

Several possible options may be considered, including specifying a percentage maximum for cancellation fees, or requiring them to be charged only after the time has elapsed and the barrister can actually verify the amount of idle time he or she was left with. However, a number of logistical difficulties arise in the implementation of such solutions, including the need to delay finalisation of the accounting for a settled matter for what might be a considerable time.

The New South Wales Director of Public Prosecutions, Mr Nicholas Cowdery, suggested that guidelines be developed clarifying when it was appropriate to charge cancellation fees and what procedures should be used. Given the complexities involved, those guidelines would probably best be developed by practitioners who are regularly involved in litigation and who understand the possible practical implications. An appropriate approach might be to establish a working party, including at representatives of the Bar Association, the Law Society and the OLSC, to develop appropriate guidelines.

Recommendation

- 8. A working group, including representatives of the Law Society, the Bar Association and the Office of the Legal Services Commissioner, should be established to develop guidelines as to the circumstances in which barristers may charge cancellation fees.**

3.7 Group or class litigation

An emerging area of difficulty is the role of third party funders in mass plaintiff litigation. The rules for conduct of these proceedings vary from jurisdiction to jurisdiction, with only the Federal Court and the Supreme Court of Victoria having formally codified rules for group representative proceedings.

Currently the usual method for conducting such proceedings is to have only one, or a small number, of nominal plaintiffs representing a much larger class of claimants. Often, only the nominal plaintiffs are formally clients of the lawyers in the litigation, but many more may have an interest in its progress. In other cases, the plaintiff's lawyers may have many other clients who are members of the class, and who will be eligible to participate in the outcome but who are not actively involved in the litigation. In still others the lawyers might maintain a register of interested persons without actually being retained by them.

The rights of those who formally retain the lawyer are clear, if cumbersome in the circumstances. Each is entitled to disclosure under both the 2004 and the 1987 Acts. However, in most mass plaintiff cases the lawyers are carrying the disbursements and out of pocket expenses, awaiting resolution (by way of decision or, more likely, settlement) before being paid or reimbursed. Full formal disclosure may become burdensome if such matters flourish, and may effectively limit participation in the market to firms with sufficient financial resources to service large groups over long periods without payment. It may be that alternative disclosure methods may need to be explored such as provision of standard form disclosures on websites or intranets.

A further complication arises when one considers the interests of the group which might perhaps be characterised as "quasi-clients". These are the people who register with a firm, who want or need to be kept up to date with progress of a case and who at some point will have to make a decision as to whether to opt in or out of any resolution. It may become necessary to define more (and possibly to constrain) this group's entitlements to be informed and advised.

A practice which has recently come to the attention of the OLSC also has bearing in this area. This involves lawyers soliciting potential plaintiffs in group litigation, and asking them to "register" with the lawyers, who will then "manage" their claims in exchange for a "once off" initial fee. If the matter is litigated and either successfully determined or settled, the lawyers would then seek to recover fees from the award of party/party costs. There is considerable confusion among the recipients of such letters as to whether or not they are retaining the lawyer to provide legal services to them. The initially requested fees are usually below the \$750 disclosure threshold (although it is arguable that if any entitlement to further fees is reserved, such as from the final settlement, then the likely fees will exceed the threshold and formal disclosure is also required).

The Legal Services Commissioner takes the view that, where legal practitioners seek fees from people on the basis of their status as potential litigants, for work which involves assessment of potential legal claims, that is work to which the *Legal Profession Act* (whether the 1987 or the 2004 version) applies. Money received on account of such work should therefore be held on trust until the work is completed, and dealt with under the rules relating to trust accounts.

The question of funds for group litigation also raises the issue of the role of litigation funders. Some funders operate simply by lending to the nominal plaintiffs on the basis that the only recourse for recovery is from the proceeds of the action. If successful, the funders recover moneys paid on account of costs and take a percentage of the remaining damages. The plaintiffs are responsible for the selection and retention of lawyers, although there is considerable variation (and some concern) at the degree of the funder's involvement in the conduct of the litigation. Others, like IMF (Australia) Ltd, operate by entering into multiple funding agreements with potential claimants who agree to retain lawyers already selected by the funder, on terms already negotiated by the funder. What are, and what ought to be, the rights of a funder to receive disclosure, at the outset and on an ongoing basis? ⁷⁸

Legal practitioners are prohibited by Section 325 of the 2004 Act from charging contingency fees. No such prohibition exists for others, and fees calculated as a percentage of the award are the standard for litigation funders. There is presently no express prohibition on lawyers being involved in litigation funding businesses, nor any limit on litigation funders' access to contingency fees, apart from the courts' concerns about whether their activities may in some circumstances amount to trafficking in causes of action. The possibility exists therefore that some lawyers may seek to circumvent the prohibition on contingency fees by holding a stake in a litigation funder. The resolution of this issue is beyond the scope of this paper.

The law on funded litigation is still dynamic and unclear. As noted above, the rules for representative litigation vary from jurisdiction to jurisdiction and the attitudes of the courts to funders also vary substantially.⁷⁹ Given this state of flux, it would be premature to recommend changes to costs and disclosure regimes in such cases. The area will however require close and ongoing monitoring.

Recommendation

- 9. Developments in mass plaintiff litigation should be closely monitored to identify any need for further amendments to the disclosure and costs provisions of the 2004 Act.**

4. ESTIMATES AND ONGOING DISCLOSURE

John W. Toothman, principal of American legal costs consultants The Devil's Advocate, observes that:

⁷⁸ Since Section 350 of the 2004 Act defines "client" to include any person who is liable to pay legal costs, funders would presumably be entitled to have bills assessed before payment.

⁷⁹ For example, contrast the views of the Western Australian Supreme Court in *Clairs Keely (A firm) v. Treacy* [2004] WASCA 277, and those of the New South Wales Court of Appeal in *Fostif v. Campbells Cash & Carry Pty Ltd* [2005] NSWCA 83. The decision in *Clairs Keely* has been reversed on further appeal, and *Fostif* is the subject of an application to the High Court for special leave.

a client cannot wait until the matter is over to understand what it might cost, the risks involved and the options... There are uncertainties in many legal matters, but that is no excuse for lawyers to abdicate responsibility for guiding their clients: experienced, competent lawyers can narrow and focus uncertainty, even if they are not psychic.⁸⁰

The 1987 Act attempted to compel this narrowing and focusing process by requiring that, where it is not possible to disclose the actual costs to be incurred for legal services, a practitioner must provide the client with an estimate of the likely total costs (Section 177(1)). Having provided an initial estimate the practitioner was then required by Section 177(3) to disclose to the client any significant increase in the estimate. Section 180, however, provided an exemption to the disclosure requirements “where it would not be reasonable to be required to do so”.

Like Toothman’s non-psychic American colleagues, New South Wales practitioners often object to being required to estimate costs on the basis that not all aspects of any matter are within their control. Despite the obvious truth in this proposition, this is not a problem unique to lawyers. Architects, builders, plumbers and most other providers of skilled services encounter similar difficulties, and the expert service provider is always in a much better position to estimate and predict this than his or her lay client.

The failure of the estimates regime, particularly the failure to provide ongoing updates, underpins many complaints made to the OLSC and is also a common feature in costs assessments. The Cost Assessors’ Rules Committee observes that:

It would be fair to say that many of the smaller claims in relation to client/practitioner assessments would have been resolved had the practitioner either rendered monthly bills or updated their costs estimates regularly. It is the experience of CARC that in the majority of practitioner/client applications for assessment practitioners do not update estimates or keep their clients fully apprised of the costs of the matter.⁸¹

The experience of the OLSC is that many practitioners who do notify of significant increases in their estimates do so only through their billing arrangements. Effectively the disclosure is given by the total of the bills approaching or exceeding the original estimate while the matter is still ongoing. This is hardly effective disclosure from the point of view of the client’s understanding of risks and options and timely planning of appropriate responses.

Australian costs expert Susan Pattison notes:

⁸⁰ John W. Toothman, *Managing Legal Fees & Lawyers; A Guide to Integrated Management of Legal Services*, www.devilsadvocate.com/manage.html

⁸¹ Robert Benjamin, *Costs Assessors’ Rules Committee Submission to the Legal Fees Review Panel*, p 2

many practitioners find the giving of estimates at the outset of a matter a rarefied form of crystal ball gazing. Some say it scares away clients.⁸²

This observation encapsulates neatly the two principal problems associated with legal costs disclosure at the present time: the failure of law firms to understand the commercial realities of pricing and, for their clients, of acquiring legal services; and the “buyer’s remorse” of (often disappointed or unsuccessful) clients who did not focus early enough on the financial realities of the instructions they were giving.

From a social policy perspective, scaring away clients who are unprepared for the financial impact of engaging a lawyer is no bad thing, reducing burdens on both the legal and regulatory systems.

The 2004 Act expands the estimate obligations. Section 309(1)(c) narrows the “not reasonable” exemption, by requiring that where it is not reasonably practicable to estimate the total legal costs a practitioner must instead provide a range of estimates and an explanation of the major variables that will affect the calculation of the costs. The client is to be informed of any substantial changes to matters contained in a compulsory disclosure, which now includes the estimate, and this is to be done “as soon as is reasonably practicable after the law practice becomes aware of the change” (Section 316).

For litigious matters, further estimates are to be provided before a negotiated settlement is executed, including estimates of fees payable by the client (whether solicitor/client or party/party costs) and of any contributions likely to be received from any other party (Section 313). These will be important considerations in determining the attractiveness or otherwise of any settlement proposal, but a number of difficulties persist. Firstly, it will be difficult to estimate with any precision the likely costs of another party, since there may be considerable variation depending on whether that party has taken a comprehensive or economical approach to preparation and representation. “Fair and reasonable” party/party costs covers a wide spectrum of possibilities.

Of more concern is the issue of recovery of contributions from other parties. Disclosure of likely contributions may lighten the heart of a litigant but it will not lighten the burden of having to pay their own costs in full long before those contributions are received.

The failure to negotiate payment of party/party costs is the subject of a significant number of complaints to the OLSC. In a typical case of this kind, the practitioner has been paid by the client, either in response to bills rendered or by deduction of the practitioner’s fees from the damages before the balance is remitted to the client. The collection of the costs awarded to

⁸² Susan Pattison, “Costing: Is failure to give an estimate the kiss of death on practitioner own client assessment?” *Law Society Journal* April 1999 p 32

the client offers no significant benefit for the practitioner, who consequently has no incentive to pursue them.

The Commissioner's view that collection of party/party costs forms part of the practitioner's retainer and should therefore be pursued diligently and competently is endorsed by the Law Society.⁸³ The Law Society suggests that this should be the subject of continuing legal education, but it is the panel's view that it is unlikely that those practitioners who show themselves to be uninterested in pursuing reimbursement for their clients after they themselves have been paid would be interested in voluntarily attending further education on the subject.

The panel is of the view that the profession should be encouraged to regard the pursuit of party/party costs awards as an integral part of the retainer of any practitioner involved in a contested matter. There should be a clear recognition that the pursuit of costs is inherent in the pursuit of any other remedy.

It may be arguable that failure to pursue party/party costs may sound in an action in negligence against the practitioner concerned. This effectively perpetuates and expands the unfairness, by placing the financial burden of further litigation and the consequent delays on the client who has already been financially disadvantaged. It would be preferable to put the matter beyond doubt and to permit the client to pursue the much cheaper option of disciplinary intervention.

One appropriate response would be to limit the ability of a dilatory solicitor to pursue his or her own costs until the matter of party/party costs has been finalised, or at least until there have been bona fide attempts to do so. In the view of Mr Glanfield and Mr Mark, a solicitor acting for a party in whose favour an award of party/party costs has been made should not be entitled to be paid his own solicitor/client costs until the payment of the party/party costs has been resolved by agreement or by assessment of a bill.

A degree of flexibility may be required, since it is not impossible to imagine situations where the client is happy for the solicitor to be paid, even though the matter of party/party costs remains outstanding. It would not be desirable in such circumstances to frustrate the desires of both client and solicitor. On the other hand, there is always a risk that solicitors would seek as a matter of course to obtain client consent to payment of their costs before resolution any party/party costs order, as a "take it or leave it" proposition at the outset of the retainer.

It may not be possible to draft a provision that would provide a fair outcome in all situations while preventing any possibility of unscrupulous exploitation. However, in the view of Mr Glanfield and Mr Mark, it would be appropriate to entrench a restriction on access to fees for solicitors who have not pursued

⁸³ Law Society of New South Wales, *Costs Working Group Submission to Legal Fees Review Panel*, p7

resolution of party/party costs orders, provided that flexibility is retained for exceptional circumstances. Mr Salier and Mr Harrison prefer that an amendment be made to the Solicitors' Rules to the effect that a solicitor should pursue assessment of party/party costs after six months if the amount payable has not been agreed within that time.

The following recommendation is made by Mr Glanfield and Mr Mark.

Recommendation

10. The Solicitors' Rules should be amended to provide that, otherwise than in exceptional circumstances and with the express consent of the client, a solicitor acting for a client in whose favour party/party costs have been awarded should not be entitled to be paid his or her own solicitor/client costs until the payment of the party/party costs has been resolved, by agreement or by assessment of a bill.

5. CONSEQUENCES OF NON-DISCLOSURE OR INADEQUATE DISCLOSURE

The disclosure and estimates regimes are critical to establishing and maintaining proper channels of communication between solicitor and client, but their effectiveness is undermined by the weakness of the available sanctions for inadequate compliance or non-compliance.

Under the 1987 Act there was no interdependence between disclosure (including the provision of estimates) and the enforcement of a costs agreement.⁸⁴ Failure to disclose was not of itself a breach of the Act, but depending on the circumstances *may have* constituted unsatisfactory professional conduct or professional misconduct (Section 182(4)).

For most practitioners, there has been little substantial sanction for failure to provide or update an estimate. Even if the failure concerned disclosure of costs under Section 175, the bill could still be assessed and the practitioner would still be entitled to be paid for work the client may never have authorised had the client understood the costs implications of changes in circumstances. The penalties were effectively only the cash flow impact of delayed payment, which for most firms is a matter of inconvenience rather than substantial difficulty, and the costs of the assessment itself.

The 2004 Act advances this position. Since estimates are now included in the compulsory disclosure required by Section 310, failure to provide or update them attracts the same sanctions as failure to make the other compulsory disclosures. If a practitioner fails to disclose, a client is not required to pay the costs until the bill is assessed at the practitioner's expense (Sections 317(1) and 369). The client may also apply to have any costs agreement entered

⁸⁴ *Hogarth & Ors v. Gye & Anor* [2002] NSWSC 32; cited in Susan Pattison, "Is a Costs Agreement Different from Disclosure?" *Law Society Journal* July 2003 p 36

into with the practitioner set aside (section 317(2)), which means that the practitioner will be entitled to have his or her fees assessed only on the basis of what the assessor thinks fair and reasonable in the circumstances.

The prohibition on the practitioner maintaining proceedings for recovery of costs pending assessment (previously contained in Section 182(2) of the 1987 Act) is also repeated, and extended to the commencement of proceedings (Section 317(3)). This is a significant improvement, since it has been the habit of some practitioners to commence proceedings in order to intimidate clients into paying disputed bills, and if challenged to seek to have the proceedings merely stayed rather than withdrawn. Failure to comply with the disclosure requirements is still not of itself unsatisfactory professional conduct or professional misconduct but *may* constitute such conduct in appropriate circumstances (Section 317(4)).

Several problems remain unaddressed. Although the costs agreement may be set aside, the practitioner is still entitled to be paid for work undertaken with less than fully informed client consent and the only substantial penalty remains the cash flow impact.

Given the critical importance of the disclosure and estimates regimes, there should be more substantial financial consequences for non-compliance or partial compliance. While it would be unfair to create a situation where an administrative error might result in a practitioner foregoing all payment for a substantial body of work undertaken in good faith, a significant reduction in the recoverable costs would provide a powerful incentive to ensure compliance.

An appropriate response would be to provide that non-compliance with the disclosure provisions (or an acceptable alternative arrangement: see discussion of budgets below in Section 6) should result in a significant costs reduction.

In light of the information set out in Figure 1 of Section 1.3 above, Mr Glanfield and Mr Mark are of the view that a 20% reduction would be appropriate, as this would have a significant impact on profit margins for the work. Mr Salier and Mr Harrison are of the view that the matter is adequately addressed by the powers provided to costs assessors by section 328 of the 2004 Act.

The following recommendation is made by Mr Glanfield and Mr Mark.

Recommendation

11 Where a practitioner fails to make the compulsory disclosures, and also fails to comply with any acceptable alternative regime, the practitioner should be permitted to recover only fees calculated on

⁸⁵ Australian Law Reform Commission, *Submission to the Legal Fees Review Panel*, 17 December 2004, p 2

the basis of the fair and reasonable value of the work, less 20%.

Particular care will be needed in drafting appropriate provisions to address situations where the non-compliance involves failure to update an estimate or to inform a client of changed circumstances under Section 316. It is suggested by Mr Glanfield and Mr Mark that, where estimates are not updated, the reduced rate of fees should apply for a limited period. The practitioner should be entitled to revert to charging costs as agreed in the retainer after providing the client with the appropriate notification. Mr Salier and Mr Harrison are of the view that the powers provided to costs assessors by section 328 of the 2004 Act are sufficient.

The following recommendations are made by Mr Glanfield and Mr Mark.

Recommendations

12 Where a practitioner fails to provide an updated estimate, and the costs billed exceed the estimate originally provided, the practitioner should not be permitted to recover fees billed in excess of that estimate except as assessed on the basis of the fair and reasonable value of the work, less 20%.

13 Where a practitioner who has exceeded an estimate subsequently provides an updated estimate, the practitioner should be entitled to recover fees calculated in accordance with the provisions of his or her retainer from the fourteenth day after the date of provision of the updated estimate.

Mr Glanfield and Mr Mark are of the view that it would also be appropriate to require costs assessors to notify the OLSC of practitioners who have not complied with the disclosure and estimates requirements. The Commissioner would then assess each referral and decide whether the non-compliance warrants his initiation of a complaint, if the matter is not already before him at some other person's motion. Although this would increase the regulatory burden, it would permit a more accurate assessment of the problem and facilitate liaison with the professional councils on the development of appropriate continuing legal education and other training. It would also enable the Commissioner to intervene by counselling practitioners who may not properly understand their obligations. Mr Harrison and Mr Salier are of the view that this matter is adequately addressed by Section 393(2) of the 2004 Act.

The following recommendation is made by Mr Glanfield and Mr Mark.

Recommendation

14 Where a costs assessor is of the opinion that a practitioner has failed to comply with the disclosure requirements of the 2004 Act, the costs

assessor should be required to refer the matter to the Legal Services Commissioner for his consideration.

In the view of the panel it should be clearly unacceptable to commence unsupportable recovery proceedings, or to have them merely stayed pending assessment. Mr Salier and Mr Harrison note that section 317(3) of the 2004 Act prohibits maintaining such actions, and the decision of Associate Justice Malpass in *Barnes & Anor v. Kalyk* ((2003) NSWSC 607) establishes that commencement of proceedings is encompassed within the concept of maintenance of proceedings. Mr Glanfield and Mr Mark are of the view that it would be preferable to put the matter beyond argument through an appropriate statutory amendment, and believe that consideration should be given to providing specifically that a practitioner who has not complied with the disclosure requirements may *neither* commence nor maintain proceedings, and must withdraw extant proceedings within 14 days of receipt of notification that an assessment has been applied for.

The following recommendation is made by Mr Glanfield and Mr Mark.

Recommendation

15 A practitioner who has failed to comply with the disclosure requirements should not be permitted to commence or maintain fee recovery proceedings until the bills in question have been assessed. Any proceedings which have been commenced should be required to be withdrawn within 14 days of receipt of notification of the application for costs assessment.

6. BUDGETS AS AN ALTERNATIVE TO DISCLOSURE

6.1 Legal budgets and their operation

The legal profession has traditionally taken the view that it is neither possible for lawyers to predict the likely financial progress of legal work, nor fair to require them to do so.

This analysis is accurate if you assume that the objective is a *prediction* of costs, and more so if that prediction is seen to be made at the outset, once and for all. In any profession the nature and extent of services required by a client will depend on the circumstances, and will evolve as the relationship progresses. As has already been discussed, what is essential for the client's maintenance of control, and eventual satisfaction with the outcome, is being able to monitor and respond to this evolving situation as it happens, making appropriate strategic and financial decisions along the way. This requires not so much a prediction as a continued stream of communication: effectively a

monitoring and management process. It is perfectly possible and entirely reasonable for lawyers, as expert service providers, to undertake it.

The emerging practice of legal budgeting is such a process, and experience in Australia and overseas indicates that it is a highly effective tool.

For example, IMF (Australia) Ltd requires lawyers retained on behalf of its funded clients to submit initial budgets as part of negotiating their retainer. Tenders are also used, with tendering firms providing initial budgets for comparison. Mr Walker of IMF states that “almost all large and mid-tier law firms around Australia have agreed to be retained by clients funded by IMF on this basis”.⁸⁶

The London Solicitors’ Litigation Association describes budgets as “a means of the client controlling and monitoring his or her legal spend with the Solicitor”. A budget is “a summary of estimated costs prepared by a [lawyer] for his or her client of the likely costs to be incurred” and is a function of four factors:

- The client’s instructions;
- The evidence [in contentious matters] or other relevant information available to the time the budget is produced;
- The advice to the client;
- The strategic and tactical choices made by the client in the light of the above.⁸⁷

In budgeted matters the legal work is managed effectively as a project, with the desired outcome being continually measured against the costs and risks, and the client enabled to respond accordingly. It is a dynamic process, with budgets being reviewed and recast in response to emerging events and or the passage of time. Currently, budgets are most commonly used for litigation but there is no conceptual reason why they should be confined to contentious matters.

There are various methods available for preparing budgets, but all are dependent on the practitioner having experience of the kind of work in hand and an understanding of how his or her firm handles it. This means that, to use budgeting successfully, a firm needs to have analysed its past experience with matters of that kind and have an understanding of the usual patterns, including the usual problems and detours which may arise.

⁸⁶ Walker, *IMF (Australia) Ltd Submission*, para 2.16

⁸⁷ London Solicitors’ Litigation Association, *Budgeting – Response to the Civil Justice Council’s Review*, May 2004, pp 1-2; www.lsla.co.uk.consultation.htm

For each matter a budget identifies the major component stages, and their constituent events. Taking into account the factors discussed above, the managing lawyer considers the tasks to be undertaken, the level of practitioner who should undertake them, and the likely time and skill requirements and assigns a cost to each task. These are then totalled, and allowances made for possible contingencies which are also priced in the same way. The compilation of these considerations constitutes the budget, which is then presented to and negotiated with the client. A demonstration of the way in which budgets are constructed is available online at www.legalbudgets.com.

A budget should also expressly allocate the risk of budget overruns and changes, and this is usually agreed with the client at the time the budget is prepared. Any number of strategies are possible: for example, the client may agree to pay budget overruns up to a certain cap; it may be agreed that the lawyer bears the risk of any overruns; overruns may be held in suspense until completion of the matter and then paid or withheld upon agreed terms (eg successful outcome or otherwise; or total overruns as a percentage of the budgeted amounts). The issue of risk is on the table throughout.

Perhaps the most significant aspect of budgets is that they are not static. The life of each budget document is limited, usually to no more than six months and preferably less, with the client and the lawyer revisiting and confirming or updating them as events unfold.

The London Litigation Solicitors Association point out:

It often means that the end figure incurred bears little relationship to the costs estimated at the beginning of the case, but there is no complaint from the client since the client has been kept fully informed along the way.⁸⁸

Mr Walker observes that:

Continual reassessment and disclosure of the estimated value of the action during the project (including continuous identification and disclosure of the project's risks)... ensure[s] the cost of the project remains proportionate to the value of the claim and the process remains the client's process.⁸⁹

As John Toothman of The Devil's Advocate puts it, "coupled with a good dose of common sense the budget creates a sort of poor man's in-house counsel"⁹⁰.

⁸⁸ London Solicitors Litigation Association, *op. cit.* p 5

⁸⁹ Walker, *IMF(Australia) Ltd Submission*, para 2.16(e)

⁹⁰ Toothman, *op.cit.*, p15

Once a firm has the necessary understanding of the area of practice, the likely course of events in a matter and the impact of its own usual practices, the preparation of a budget should not be an unduly complex matter. Most matters, including commercial litigation, could be budgeted using a spreadsheet tool such as Microsoft Excel, or for extremely complex matters project management software such as Microsoft Project. The London Solicitors Litigation Association is of the view that legal matters probably do not need software as complex as that required for large building projects. Specialist legal budget software is also available, for example that sold by Legal Budgets in the United Kingdom, and some law firms in the United Kingdom have devised their own budgeting software. Undoubtedly, local variants will rapidly develop to meet market demand.⁹¹

6.2 The benefits of budgets

An increase in the use of budgeting, and the consequent movement away from simple time billing, would have a number of advantages: for clients, for legal practitioners and for the community overall.

- Budgets are most easily used by experienced practitioners. In as much as they encourage clients towards such practitioners they can be expected to bring down overall transaction costs and particularly systemic litigation costs.
- The work necessary to assess a firm's business and professional practices to enable them to prepare budgets increases the focus on efficiency and productivity. Areas for improvement are likely to be identified and eliminated.
- This process is likely to build more resilient and economically sustainable legal practices
- The focus on risk allocation will provide incentive for passing on productivity increases, by making such practitioners more competitive.
- The negotiation process inherent in managing budgets is likely to drive exploration of alternative billing and pricing mechanisms, decreasing reliance on simple billable hours.
- Clients who are kept informed are less likely to complain about the cost of a matter, reducing regulatory and costs assessment burdens over the medium to longer term. (Some increases are likely in the short term as new measures are bedded down.)

⁹¹ See the discussion of various budgeting software in London Solicitors Litigation Association *op.cit*, p 8. Legal Budgets also provides an explanation and demonstration of its software at www.legalbudgets.com.

- Clients will be able to cross-reference bills to budgets, with the likely result of more clearly focused, and consequently cheaper, costs assessments.
- Particularly in litigious matters, the project management aspect of budgeting will focus attention on the viability of actions and is likely to facilitate earlier settlements and discourage unrealistic commencement of cases.
- Budgeting reduces the tension, inherent in time costing, between keeping costs down and keeping the client informed. It is in both sides' interest to negotiate the budget.
- Budgeting is conducive to competitive tendering and to comparison shopping.

6.3 Budgets and the Legal Profession Act

The most effective way to encourage a movement towards budgeting and away from simple time based pricing would be to amend the 2004 Act to provide that budgets, properly prepared, could substitute for the disclosures required under Section 309.

The operation and implementation of such an amendment will need to be carefully monitored. Since it is recognised that lasting change to professional practices depends on organic development, it is necessary to leave room for this, and for market experimentation to take place.

Recommendation

16 Practitioners should be permitted to comply with a statutorily provided budgeting process as an alternative to the compulsory disclosure regime.

In allowing budgets to substitute for formal disclosure there is a risk that budgets will become “take it or leave it” propositions for retail customers. However detailed regulation to prevent this would be an additional intrusion, and it would not be appropriate to add to an already heavy regulatory burden when the problem may not arise. Since the budget process is strongly focussed on negotiation, and because the component parts of the matter are separately identified and costed, there is much more room for informed client participation.

For a budget to be an acceptable substitute for Section 309 disclosure it would have to meet minimum standards, which should include:

- Identifying the stages of the matter, the tasks to be undertaken within each stage, and allocating a cost to each task;
- Identifying likely disbursements and allocating a cost to each;
- Specifying the intervals, not less than quarterly, at which the budget is to be reviewed;
- Specifying the allocation of risk if the budget is exceeded: i.e. who bears the cost of a budget overrun;
- Providing a rights statement (as discussed in Section 3.3 above) to clients;
- Setting out the agreed billing intervals;
- Detailing the rates of interest if any to be charged on unpaid bills;
- Identifying a managing lawyer responsible for negotiation and compliance with the budget and with whom the client can speak about either transactional or budgetary matters.

Budgets should be required to be reduced to writing and client acceptance of them evidenced by a signed copy. The cost of preparing budgets should not be able to be passed on to the client, but having agreed to proceed by way of budget the right to progress reports under Section 318 should not apply since the information should be provided in the budget and billing process in any event.

Recommendations

17 That, to be acceptable, a budget should be required to:

- a. Identify the stages of the matter and the tasks to be undertaken within each stage, and to allocate a cost to each task;**
- b. Identify likely disbursements and allocate a cost to each;**
- c. Specify the intervals, not less than quarterly, at which the budget is to be reviewed;**
- d. Specify the allocation of risk if the budget is exceeded;**
- e. Provide a rights statement;**
- f. Set out the agreed billing intervals;**

- g. Detail the rates of interest, if any, to be charged on unpaid bills;**
- h. Nominate a managing lawyer responsible for negotiation and compliance with the budget and with whom the client can speak about either transactional or budgetary matters.**

18 Budgets should be required to be updated at least quarterly.

19 Budgets should be required to be evidenced in writing and signed by the client.

20 A practitioner should not be permitted to charge for preparing or updating a budget.

21 Section 318 of the 2004 Act should not apply to budgeted matters.

To be effective, each matter requires its own budget. The “master disclosure” exceptions to disclosure provided in Section 312 should not apply to the use of the budgeting alternative. The other exemptions to compulsory disclosure set out in Section 312 should however apply to the use of budgets.

Recommendation

22 A separate budget should be required to be prepared for each matter or case, even if for the same client.

Careful attention will need to be paid to the costs implications of failure to comply with the requirements of the Act in budgeted matters. If the client and lawyer failed to agree on a revised budget, the position would be the same as with any other dispute: negotiations would ensue and if unsuccessful one or other party would terminate the retainer.

Some amendments would also need to be made to the costs assessment rules and procedures to address matters run by budget. Amendments would be needed to create a parallel situation to that provided under Section 317. Provided that a bill relates to a budget signed off by a client in accordance with the requirements of the Act, there should be no impediment to the practitioner seeking to enforce the bill, subject to compliance with Section 355 (which forbids commencement of proceedings where a costs assessment has been applied for).

An assessment would begin by considering the agreed budget, and determining whether on its face the costs agreed are fair and reasonable. If the budget is fair and reasonable, the bill should then be assessed against the budget. If the budget is determined not to have been fair and reasonable, the bill should be assessed on a “fair and reasonable” basis with the proviso that the amount recoverable may not exceed the amount specified in the budget.

Costs assessors should be required to notify the Office of the Legal Services Commissioner of any budget which they consider to be grossly inflated.

Recommendations

- 23 A practitioner should be entitled to enforce a bill issued in accordance with a budget in the usual way.**
- 24 On assessment a practitioner should be entitled to recover costs calculated in accordance with a compliant budget, provided that the costs assessor considers the budget to have been fair and reasonable at the time it was agreed.**
- 25 If a costs assessor forms the view that a budget was not fair and reasonable at the time it was agreed, the practitioner should be entitled to recover his or her fair and reasonable costs for work actually done.**
- 26 Costs assessors should be required to refer to the Legal Services Commissioner any matter in which they consider a budget to have been grossly inflated.**

It is inevitable also that situations will arise where budgets are not updated as required, and work continues even though it is not covered by a current budget. In such circumstances the practitioner should be permitted to recover fees for work done only on the reduced basis discussed above in Section 5 above (i.e. fair and reasonable rates, less 20%), for the period commencing on the date of expiration of the last agreed budget until the period commencing on the date of the next agreed budget.

Recommendations

- 27 Where a practitioner fails to negotiate an updated budget within the time specified in the existing budget, the practitioner's fees for all work done after the date on which the budget should have been updated should be assessed in on the basis of the fair and reasonable value of the work done, less 20%.**
- 28 Where a practitioner who has failed to negotiate an updated budget subsequently does so, the practitioner should be permitted to recover fees according to the updated budget as from the date on which the updated budget is agreed.**
- 29 If Recommendations 16 to 28 inclusive are adopted, a working party should be convened to consider and make recommendations as to the most appropriate methods for their implementation.**

7. BILLING PRACTICES

Complaints about bills dominate the matters that come to the OLSC.

A number simply concern the size of the bill, and revolve around a mismatch between the client's expectation and the lawyer's invoice. Clients do not always understand the nature of the work undertaken on their behalf and, particularly when they are not kept fully informed of developments in their matter, are not in a position to keep themselves abreast of the likely cost. On the other hand, when providing the bills and narratives of progress is time costed, the more the client is kept informed the larger the bill he or she has to pay. In some circumstances, even the reporting correspondence itself can become a confusing burden to a distressed person.

Once again, the critical factor is communication.

The Austrian school of economists pointed out in the nineteenth century that value is subjective – i.e. goods and services are only valuable to the extent there is a valuer desiring them. This desire is in turn driven by customers' expectations. Communication which addresses and manages expectations is critical to clients' perceptions of the value of the services provided to them.⁹²

According to Ronald J. Baker there are three main emotions associated with pricing:

- *Price resistance*, which is encountered at the initial retainer phase;
- *Price anxiety*, or “buyer's remorse”, which is encountered after the retainer, when the client is insecure about the decision to proceed; and
- *Payment resistance*, which is encountered after the work is billed.

All sellers encounter price resistance, and learn to overcome it by persuading the customer of the advantages of their products or services. Those who don't, rapidly go out of business.

Price anxiety is minimised by staying in touch with the customer, reinforcing and supporting the decision to acquire the services. Payment resistance is minimised by involving the customer in design and payment terms.⁹³

Clearly, billing practices can have a dramatic impact on either encouraging or minimising price anxiety and payment resistance. Good billing practices can reduce the emotion involved and facilitate appropriate communication and negotiation, while those practices which fail to address or manage client expectations generate dissatisfaction, and hence complaints.

⁹² Baker, *op.cit.* p 13

⁹³ Baker, *op.cit.* pp 21-24

Formal requirements designed to enhance this process would be likely to result in a better performing profession.

7.1 Late final bills

Each year, more than 20 complainants to the OLSC find themselves in receipt of a bill for legal work undertaken more than five years previously. Often these bills are issued because an outside party such as an accountant has been engaged to call in the debts owed to a practice which has been poorly organised or administered. A further group of complainants receives bills for work completed many months or several years earlier in matters they thought were long finished. This can cause enormous distress and disruption for people who have organised their lives and their finances on the basis that outstanding liabilities had been dealt with.

There is no justification in permitting such distress, or benefit in encouraging the continuation of poor administrative and management practices in law firms.

Bills should be required to be rendered within a reasonable time of the completion of the work in a matter. An appropriate period would be no longer than a year, and preferably six months.

Recommendations

30 Practitioners should be required to render a final account in any matter no later than six months after completion of the matter.

31 A practitioner should not be entitled to charge interest on any final bill rendered later than six months after the completion of a matter.

7.2 Irregular and unexpectedly high bills

Payment resistance is likely to develop when a client receives a bill for an unexpectedly large amount, particularly where the amount exceeds the expected total.

Especially when involved in a fast moving transaction or a highly emotionally charged dispute, the client's focus of attention is the outcome, with less attention paid to fees building up. When the emotion is spent and the outcome either achieved or missed, then the focus shifts to the price. To keep the client focussed along the way on the management of the risk involved, and on the relative costs and benefits of the outcome being pursued, it is important that attention is regularly re-drawn to these issues.

The disclosure and estimates regime contributes to this process and would be supported by complementary billing practice requirements. A client made conscious of the unfolding relationship between budget and expenditure is

more likely to feel in control, and to assert control, of his or her legal expenses.

An appropriate change would be to require each bill rendered to state the total fees billed in the matter to date and to express that total as a percentage of the most recent estimated or budgeted figure provided to the client. The lawyer, who is calculating the bills, is in a much better position than the client to compare them to the estimates he or she has already provided and a requirement to consider the percentage expenditure would also serve as a spur to the timely revision of estimates or renegotiation of budgets.

If Recommendation 2 above is implemented it would also be desirable, as is the requirement in Family Court Rule 19, for each bill to refer the client to the rights notice provided to them at the time of the retainer.

Recommendation

32 Each bill or interim bill rendered by a legal practitioner should be required to:

- a. set out the total amount billed in the matter to the date of the bill;**
- b. express that amount as a percentage of the amount of the most recent estimate or budget provided to the client; and**
- c. refer the client to the rights notice provided at the commencement of the retainer.**

Some practitioners, for internal business reasons, from time to time choose to delay rendering bills. Others do so inadvertently. Whatever the reason, irregular bills contribute to clients' losing sight of their total legal expenditure, and to the accumulation of unexpectedly large debts. It is unlikely that internal reasons would legitimately warrant extensive delays in rendering bills. If they did, it is arguable that this puts the practitioner's interest and the client's in conflict, and that the client's interest ought to prevail. Mr Glanfield and Mr Mark believe that a simple mechanism mandating periodic billing would be of assistance. Mr Salier and Mr Harrison are of the view that, since Sections 309(g) and 318 of the 2004 Act permit clients to call for progress reports and reports of costs, such a provision is not necessary.

The following recommendation is made by Mr Glanfield and Mr Mark.

Recommendation

33 Legal practitioners should be required to provide their clients with bills no less frequently than quarterly, unless they have agreed to bill only at the completion of the matter.

In personal injury matters it is common for practitioners not to render bills until an outcome is achieved, and then to deduct the solicitors' fees from the final recovery. This practice is of great assistance to injured people whose disposable income has been correspondingly reduced. However, an absence of bills can lead the client to unrealistic expectations about the amount of the final award that will be his or hers to keep. Throughout the matter the client still needs to make decisions and to give instructions, and may well feel at the conclusion that these would have been different had he or she fully grasped the likely cost.

Mr Glanfield and Mr Mark are of the view that it would therefore be prudent to require that such clients be regularly provided with statements of account showing the costs and disbursements as they accrue. On the basis of the provisions of Sections 309(g) and 318 of the 2004 Act discussed above, Mr Salier and Mr Harrison are of the view that such an amendment is not necessary.

Recommendation 34 is made by Mr Glanfield and Mr Mark.

Recommendations

34 Where a practitioner and client agree that bills will not be rendered until conclusion of a matter, the practitioner should be required to provide the client with a statement of accrued costs and disbursements at least quarterly.

35 Each statement of accrued costs and disbursements should be required to express the amounts accrued as at the date of the statement as a percentage of the total amount referred to in the estimate or budget last provided to the client.

7.3 Uplift fees

Section 186 of the 1987 Act permitted a legal practitioner to enter into a conditional costs agreement (i.e. one where the practitioner is paid only if there is a satisfactory outcome) which included a premium of up to 25% of his or her costs. Section 324 of the 2004 Act prohibits the "25% uplift" in relation to claims for damages. It is still permitted for transactional work, and in relation to litigation in which other remedies are sought.

The principal use of uplift fees has been in relation to personal injuries litigation and cases where the practitioner carries the professional fees and disbursement costs until completion. It is a common feature of "no win no fee" style agreements. Section 324 is for most practical purposes an abolition of the 25% uplift premium.

There are real concerns that the ability to conduct litigation without regard to costs encourages speculative cases and ambit claims, and discourages early settlements. On the other hand, the injuries which are the subject matter of many cases undertaken on this basis have themselves removed the client's ability to fund anything beyond their own basic needs. Without access to either legal aid, litigation funding or a practitioner prepared to pay for disbursements and wait for a very long time for his own fees, such people are effectively locked out of using the courts to seek redress.

The Law Society and the Australian Lawyers' Alliance see the issue as one of reward for the assumption of risk.⁹⁴ There are conceptual difficulties with this position, since the assumption of risk is inherent in any business activity and it is not necessarily unreasonable to expect lawyers to share risk with their clients as a normal part of their commercial operations.

The Young Lawyers' Section notes that although Section 198J of the 1987 Act requires a practitioner not to act in a matter unless there are reasonable prospects of success, this is not the same as an elimination of risk. Reasonable prospects of success also entails reasonable prospects of partial or complete failure, and where the client is impecunious the lawyer is therefore assuming the risk of not being able to recover considerable amounts of money accrued over a considerable period of time. The Young Lawyers' Section analyses the uplift fee as being intended to compensate for the fact that the lawyer in these circumstances is acting as a de facto litigation lender.

The financial risk and burden this places on the practitioner and the firm is significant as the firm is "lending" the plaintiffs funds with which to run an action which the plaintiffs would otherwise not be in a position to run. From a financial point of view the uplift can be seen, in part, as effectively an "interest rate" applicable to a high risk investment.⁹⁵

In the view of the Young Lawyers' Section, the consequences of the change are likely to be an increase in hourly rates for such matters, and a reduction in the number of such cases firms are prepared to take on on a contingent fee basis. This in turn presents the real possibility of a reduction in equitable access to the justice system for the most disadvantaged members of our community.

Civil rights exist, but are symbolic unless the architecture of the legal system provides a remedy correlative to those rights.⁹⁶

Alternative approaches to the complete elimination of uplift fees should be considered, limiting them for example to cases where liability is in issue, rather than quantum alone, and/or cases where the practitioner has carried both the professional fees and the disbursements throughout the case.

⁹⁴ Law Society, *Submission*, p 13; Australian Lawyers' Alliance, *Submission*, p 11

⁹⁵ Young Lawyers Section, *Submission to Legal Fees Review Panel*, p 8

⁹⁶ Australian Lawyers Alliance, *op. cit.* p 15.

Another alternative would be to adopt the Young Lawyers' analysis of the uplift fee as de facto interest, and to provide instead for the charging of interest on either disbursements alone or disbursements and professional fees incurred in cases where the practitioner carries these costs until completion. Viewed in this light an interest rate of 25% is excessive and a more appropriate rate would be the rate currently applicable to interest on Supreme Court judgements or an appropriate bank interest rate.

Recommendation

36 Practitioners who carry the costs of professional fees and disbursements throughout the course of a matter should be entitled to charge interest on those fees and disbursements at the rate provided for in paragraph 110A of the Legal Profession Regulation 2005.

In the area of transactional work, particularly large commercial matters, the limitations placed on the uplift fee may restrict the flexibility of solicitors' firms in relation to alternative fee arrangements.

The difficulty arises principally from the operation of Section 324 of the 2004 Act, which provides in subsection (3) that a premium must be "a specified percentage of the legal costs otherwise payable", and in subsection (4) that "the premium may not exceed "25% of those costs".

As pressure for lawyers to share transaction risk mounts, pressure to reduce the day to day legal fees of a transaction in favour of hefty "success fees" also increases. However, where there is an agreement to discount fees pending a successful outcome, it is unclear whether the "legal costs otherwise payable" which constitute the basis for the calculation of the premium should be interpreted as referring to the notional full fee or the discounted fee actually payable. If the discounted fee is the basis, then the outcome will be that either the "success fee" is greatly reduced or that the whole agreement is void, by reason of the operation of Section 327(1) of the 2004 ("A costs agreement that contravenes...any provision of this Division is void"). Similarly, the status of agreements which specify hourly rates for the transactional work, plus a flat fee upon success, remains uncertain until completion of the matter because only then will it be possible to calculate the success fee as a percentage of the "fees otherwise payable".

These outcomes may incline firms away from commercially innovative pricing structures. On the other hand, notwithstanding the provisions of Section 327(1), it would be highly unusual for any dispute over payment of fees in such transactions to be resolved otherwise than by negotiation between the parties and an outcome which involved the solicitors' firm receiving no fees at all would be most unlikely.

The operation of this aspect of the 2004 Act is complex and detailed consideration of it is beyond the scope of this paper. However it would be

prudent to investigate the operation of uplift fees in non-litigious matters more fully.

8. MARKET INFORMATION AND EDUCATION

Information asymmetries produce market failure and warrant regulatory intervention to correct them. To reduce the need for increased regulation, an available alternative is to provide the market with more information of a kind which will stimulate competition.

There is evidence that, despite the regulatory intervention which has taken place to date, the market for legal services in New South Wales is still characterised by significant information asymmetries, which make it difficult for consumers to select and retain appropriate practitioners.

A number of the consumers who made submissions in response to the Discussion Paper expressed their frustration at the unavailability of information by reference to which they could assess the value provided by their lawyers. Key observations include:

There is no benchmark to which they can refer to assess costs charges. It was a mistake to abolish cost scales and allowable counsel's fees. These scales should be reinstated: not as a binding matter on practitioners' fees but as a statement of what will be allowed for costs items and counsel's fees, to be varied upwards but not downwards in any particular case.⁹⁷

It seems that there is insufficient data on which to base any meaningful analysis of ...costs. There is no information publicly available on what lawyers charge for various services or how long a typical service should take to be performed.⁹⁸

Most important is that there should be some guideline from the Law Society and the Attorney General's Department about the limits to costs and the reasonable cost for particular types of cases which are uncomplicated. For example, if an Appeal would normally cost \$5000, then clients should know that the law firm asking for a \$15,000 security is charging at a higher rate – for whatever reason. Only with this information can the client make an informed decision.⁹⁹

The Australian Law Reform Commission has also commented on the need for consumers to be able to make informed choices about their spending on legal services.

The lack of consumer information on the costs of legal services is a major factor inhibiting downward pressure on legal fees, and thus retarding

⁹⁷ Mr A. Saxon, *Submission to Legal Fees Review Panel*, p 3

⁹⁸ Burgess, *LawConsumers Inc Submission*, p 2

⁹⁹ Penhall-Jones, *Submission*, p1

access to justice. Consumers informed about the range of legal services available and the likely charges and time commitments are in a better position to negotiate fee agreements and make informed choices about their legal advisers.

This type of information is already available to institutional consumers of legal services such as government departments and agencies, insurance companies and other large corporations who are repeat players. It assists them to compare, assess and negotiate fees, and to drive hard and effective bargains with lawyers. Major repeat purchasers of legal services are also in a position to seek tenders for legal work, or to establish their own in-house legal offices.

The information available to consumers of legal services is asymmetric. Due to disclosure requirements, people may have better, early information from their solicitor on how much their matter will cost, but little additional information to compare this with or to place it into a meaningful context.¹⁰⁰

An effective and holistic response would be to devote resources to research on legal practice management issues, their economic impacts and the inherent ethical issues. As discussed above, there is very little data available in the public arena about the economic aspects of legal practice management or their impacts on the wider community and the justice system. Some research is undertaken (for example by the Financial Management Research Centre of the University of New England) and provided to the professional societies, but this material is regarded as confidential and is not made public.

There is also little research or publicly available data on:

- how law firms in New South Wales communicate with their clients;
- how they handle complaints that don't progress to the regulator;
- how they balance their professional and business obligations;
- the economic drivers of practice; or
- how any of these factors feeds into the economics of the profession and the legal system overall.

This lack of comprehensive data makes framing appropriate policy both difficult and risky, and supports the information asymmetry in the market for legal professional services. Both professional cultural change, and appropriate policy responses, would be greatly facilitated if more, and more

¹⁰⁰ Australian Law Reform Commission, *Managing Justice Report*, pars 4.56 - 4.67, quoted in Australian Law Reform Commission, *Submission to Legal Fees Review Panel*, p 3.

¹⁰¹ ALRC, *Managing Justice Report*, Rec. 30, quoted in ALRC *Submission to Legal Fees Review Panel*, p3.

academically sound, research were undertaken and more thorough discussion entered into.

This would be best achieved by the establishment of a formal, funded and independent research capacity, under the supervision of the Legal Services Commissioner, with a brief to examine and publicly discuss issues of law firm economics, legal practice management and their economic impacts on the overall legal and justice systems. The results of this research and discussion would then be available to the public, academia and, perhaps most importantly, to those institutions which train lawyers before and after their admission to practice.

Mr Salier and Mr Harrison are of the view that the results of such research should be provided to a working group for publication of a report, rather than provided directly for public discussion.

The following recommendation is made by Mr Glanfield and Mr Mark.

Recommendation

37 A formal and independent research capacity should be established within the Office of the Legal Services Commissioner to examine and publicly discuss issues of law firm economics and legal practice management, and their economic impacts on the overall legal and justice systems.

9. CONCLUSION

For some time there has been concern in the legal community, and in the general community, about the cost of acquiring legal services, especially in relation to access to the court system. In this debate, considerable attention has been paid to the role played by lawyers' fees and charges.

The rising cost of access to legal services is a complex phenomenon, of which lawyers' fees are but a component part. A comprehensive response will need to be a systemic one, which addresses issues such as the impact of court and judicial practices (such as list management and matter scheduling) and the role of the tax system in creating and supporting unequal access.

It is undeniable that lawyers' fees and charges also contribute to the problem, and this paper has provided a range of proposals designed to reduce this contribution.

These recommendations are directed at achieving particular outcomes, rather than at the mechanisms by which they are to be implemented. Where a statutory amendment or other mechanism is considered particularly appropriate this is included, but otherwise no position is taken as to the most appropriate means of achieving the desired outcome.

Just as an appropriate response to the overall problem will need to proceed from a systemic analysis, so too must a response to the contribution of lawyers.

The proposed response set out in this paper attempts to be both holistic and systemic. It is underpinned by three foundational principles:

- In the short to medium term, improving communication and transparency of information between lawyers and their clients. This will lead to better management of their mutual expectations, and should over time reduce opportunities for dissatisfaction.
- In the medium to longer term, encouraging cultural change in the legal profession, reducing the dominance of time billing as a price mechanism and moving toward more actively negotiated and more directly value-based remuneration.
- In the medium to longer term, providing information to the market which will help to reduce the information asymmetries which currently distort it.

If implemented, the Panel believes that the combined effect of the recommended changes would, over time, contribute significantly to a more efficient market for legal services in this state.

SUMMARY OF RECOMMENDATIONS

Recommendations marked with an * made by Mr Glanfield and Mr Mark.

1. Where compulsory disclosures are included in a costs agreement or other contract between a practitioner and a client, they should be required to be set out in a separate schedule or annexure.
2. Practitioners should be required to provide a standard form rights notice to all clients at the time of retainer, other than clients which are public companies or government instrumentalities.
3. The rights notice should include at least:
 - a. A statement of the client's right to receive bills;
 - b. A statement of the client's rights to have bills assessed;
 - c. A statement of the circumstances under which a solicitor may transfer moneys held in trust to the solicitor's office account;
 - d. explanations of the terms "disbursement", "party/party costs" and "solicitor/client costs";
 - e. Details of how party/party costs may be recovered;
 - f. A summary of the practitioner's rights, including the right to exercise a lien, if bills are not paid.
4. A practitioner should be required to disclose to a client the existence and nature of any relationship between the practitioner, the practitioner's firm or any member of the practitioner's firm and any service provider proposed to be retained to provide services for which the client will be charged.
5. No practitioner, or practitioner's firm, should be permitted directly or indirectly to make a profit on disbursements.
6. Practitioners should not be permitted to charge separately for disbursements in the nature of overheads: i.e. other than payments to independent third parties unrelated to the practitioner or any member of his or her firm.
7. Where:

a practitioner proposes to retain a third party expert, other than another legal practitioner, on behalf of a client; and

the practitioner expects that that expert's fees will exceed \$1000; then

the practitioner should be required to:
-obtain an estimate of the expert's fees:
-provide that estimate to the client; and
-obtain the client's consent prior to retaining the expert.

An exception should be provided for urgent situations.

8. A working group, including representatives of the Law Society, the Bar Association and the Office of the Legal Services Commissioner, should be established to develop guidelines as to the circumstances in which barristers may charge cancellation fees.
9. Developments in mass plaintiff litigation should be closely monitored to identify any need for further amendments to the disclosure and costs provisions of the 2004 Act.
10. *The Solicitors' Rules should be amended to provide that, otherwise than in exceptional circumstances and with the express consent of the client, a solicitor acting for a client in whose favour party/party costs have been awarded should not be entitled to payment of his or her own solicitor/client costs until the payment of the party/party costs has been resolved, by agreement or by assessment of a bill.
11. *Where a practitioner fails to make the compulsory disclosures, and also fails to comply with any acceptable alternative regime, the practitioner should be permitted to recover only fees calculated on the basis of the fair and reasonable value of the work, less 20%.
12. *Where a practitioner fails to provide an updated estimate, and the costs billed exceed the estimate originally provided, the practitioner should not be permitted to recover fees billed in excess of that estimate except as assessed in accordance on the basis of the fair and reasonable value of the work, less 20%.
13. *Where a practitioner who has exceeded an estimate subsequently provides an updated estimate, the practitioner should be entitled to recover fees calculated in accordance with the provisions of his or her retainer from the fourteenth day after the date of provision of the updated estimate.
14. *Where a costs assessor is of the opinion that a practitioner has failed to comply with the disclosure requirements of the 2004 Act, the Costs Assessor should be required to refer the matter to the Legal Services Commissioner for his consideration.
15. *A practitioner who has failed to comply with the disclosure requirements should not be permitted to commence or maintain fee recovery proceedings until the bills in question have been assessed. Any proceedings which have been commenced should be required to

be withdrawn within 14 days of receipt of notification of the application for costs assessment.

- 16.** Practitioners should be permitted to comply with a statutorily provided budgeting process as an alternative to the compulsory disclosure regime.
- 17.** That, to be acceptable, a budget should be required to:
 - a.** Identify the stages of the matter and the tasks to be undertaken within each stage, and to allocate a cost to each task;
 - b.** Identify likely disbursements and allocate a cost to each;
 - c.** Specify the intervals, not less than quarterly, at which the budget is to be reviewed;
 - d.** Specify the allocation of risk if the budget is exceeded;
 - e.** Provide a rights statement;
 - f.** Set out the agreed billing intervals;
 - g.** Detail the rates of interest if any to be charged on unpaid bills;
 - h.** Nominate a managing lawyer responsible for negotiation and compliance with the budget and with whom the client can speak about either transactional or budgetary matters.
- 18.** Budgets should be required to be updated at least quarterly.
- 19.** Budgets should be required to be evidenced in writing and signed by the client.
- 20.** A practitioner should not be permitted to charge for preparing or updating a budget.
- 21.** Section 318 of the new Act should not apply to budgeted matters.
- 22.** A separate budget should be required to be prepared for each matter or case, even if for the same client.
- 23.** A practitioner should be entitled to enforce a bill issued in accordance with a budget in the usual way.
- 24.** On assessment a practitioner should be entitled to recover costs calculated in accordance with a compliant budget, provided that the costs assessor considers the budget to have been fair and reasonable at the time it was agreed.

- 25.** If a costs assessor forms the view that a budget was not fair and reasonable at the time it was agreed, the practitioner should be entitled to recover his or her fair and reasonable costs for work actually done.
- 26.** Costs assessors should be required to refer to the Legal Services Commissioner any matter in which they consider a budget to have been grossly inflated.
- 27.** Where a practitioner fails to negotiate an updated budget within the time specified in the existing budget, the practitioner's fees for all work done after the date on which the budget should have been updated should be assessed on the basis of the fair and reasonable value of the work, less 20%.
- 28.** Where a practitioner who has failed to negotiate an updated budget subsequently does so, the practitioner should be permitted to recover fees according to the updated budget as from the date on which the updated budget is agreed.
- 29.** If recommendations 16 to 28 inclusive are adopted, a working party should be convened to address the most appropriate methods for their implementation.
- 30.** Practitioners should be required to render a final account in any matter no later than six months after completion of the matter.
- 31.** A practitioner should not be entitled to charge interest on any final bill rendered later than six months after the completion of a matter..
- 32.** Each bill rendered by a legal practitioner should be required to:
 - a.** set out the total amount billed in the matter to the date of the bill;
 - b.** express that amount as a percentage of the amount of the most recent estimate or budget provided to the client; and
 - c.** refer the client to the rights notice provided at the commencement of the retainer.
- 33.** *Legal practitioners should be required to provide their clients with bills no less frequently than quarterly, unless they have agreed to bill only at the completion of the matter.
- 34.** *Where a practitioner and client agree that bills will not be rendered until conclusion of a matter, the practitioner should be required to provide the client with a statement of accrued costs and disbursements at least quarterly.
- 35.** Each statement of accrued costs and disbursements should be required to express the amounts accrued as at the date of the

statement as a percentage of the total amount referred to in the estimate or budget last provided to the client.

- 36.** Practitioners who carry the costs of professional fees and disbursements throughout the course of a matter should be entitled to charge interest on those fees at the rate allowed by the Supreme Court.
- 37.** *A formal and independent research capacity should be established within the Office of the Legal Services Commissioner to examine and publicly discuss issues of law firm economics and legal practice management, and their economic impacts on the overall legal and justice systems.

APPENDIX A

A DISCUSSION OF ISSUES RELATED TO RESEARCH AND EDUCATION

MARKET AND CONSUMER EDUCATION

In its submission in response to the Discussion Paper, the ALRC recommended

Publication by legal professional associations and legal services commissioners of the range of charge rates for lawyers in different specialities, firm sizes (including for firms situated in the central business districts, and suburban regional areas) and fees charged by barristers of varying experience.¹⁰²

There is considerable merit in this proposal, but care would need to be taken to ensure that there are no unwarranted anti-competitive effects from doing so.

An effective information mechanism must:

- Protect underlying confidential data
- Not identify particular sources of data
- Support price competition rather than price uniformity
- Not operate as a price inflator
- Be presented in a form which is easily used and understood by consumers.

Provision of research data to the market

The most effective information for supporting consumer choice is likely to be information of a kind which indicates a range or band of likely charges for a typical matter. Armed with this information a consumer is better placed to assess where an estimate falls within a band, and indeed would not need to receive an estimate but would be free to consult potential lawyers and enquire where their firm's fees for a standard transaction fit within a standard band. There is currently no publicly available research or data of this kind.

¹⁰² ALRC, *Managing Justice Report*, Rec. 30, quoted in ALRC *Submission to Legal Fees Review Panel*, p3.

The following discussion canvasses a potentially appropriate research methodology for developing and providing information of this kind.

It is a truism that there is no such thing as a typical matter, and it would be necessary in constructing bands to ensure that the data provided by each firm would be comparable. Any final research and data collection methodology would best be determined by an experienced researcher, but one possibility would be to construct a number of sample matter scenarios, encompassing defined events and a common set of facts. Firms would then be asked to provide replies to a survey indicating how much they would charge for each matter, and breaking those charges down into specified segments.

A significant amount of work would need to go into creating the sample matters and identifying the component stages. Many firms that specialise in particular areas of work already do this internally and could be consulted to ensure the integrity of this stage of the process.

In order for the integrity and validity of the data to be maintained it would be necessary for it to be sourced as widely as possible. Answering questions on costing in such a survey would be time consuming and it would likely lower the rates of response if participation were optional. Since low rates of response would render the results unreliable, it may be necessary to legislate to require firms to submit responses for all sample matters in which their firm practices.

The resultant data would then be collated and aggregated so that the responses of particular firms could not be identified. The results could then be compiled to provide ranges of charges for particular sample matters, and each of the identified component stages. These bands could then be broken down further to provide sub-bands for geographical area and size of practice.

The collection, analysis and publication of the band data would need to be undertaken by a body outside the professional associations of lawyers, to ensure that the process did not facilitate the perception of collusive behaviour. It would need to be rigorously and soundly prepared by an independent person with appropriate academic qualifications and experience.

To be truly effective, an appropriately funded and targeted advertising and information campaign would also be required to ensure public attention is drawn to the material. This would require repetition from time to time after an initial launch.

A client looking for a lawyer would be able to use the indicative band rates to make informed queries about how their matter differs from the standard one and why the charges the practitioner estimates are at the higher or lower ends of the appropriate band or sub-band. Providing such explanations would also present practitioners with marketing opportunities, whereby they can explain the quality and advantages of their services as against their competitors. The

material would need to be made available in a variety of forms, including hard copy and on line access, including through public library facilities.

The combination of the process of collecting the data and providing band information to the community would have a number of significant benefits for the legal services market, driving it toward more efficiency. These would include:

- Increased transparency;
- Facilitation of moves away from time costing, since the analysis needed to provide the research data could also then be used to underpin alternate fee structures;
- Encouragement for law firms to focus on management, budget and service provision cost issue;
- An expected resultant reduction in complaints about firms.

With the passage of time, the data and the bands would of course become inaccurate. However, if the process of compiling and publishing the material has the anticipated effects it may not be necessary to repeat it, as the issues in relation to legal costs may well have changed

Client education

The major thrust of the disclosure regime in the 2004 Act, and of the changes suggested in this paper, is to educate clients about their relationships with legal services providers. Most of this education is however directed at small or “retail” customers, since most is known about the issues and concerns of this group.

This is somewhat at odds with experience. Changes in firm management practices, and particularly in billing and charging practices, have historically been driven by the bigger commercial firms. Contracting out of scale costs, and then time recording and time billing, began in these firms and from there gradually spread to smaller practices.

On the basis of this experience cultural change in the profession is likely to be best effected by bringing about change in large firm thinking and practices. Commercial firms build their success on being responsive and attentive to the commercial needs of their clients. That they do so is reflected in the low level of complaints from such clients and about such firms received by the OLSC.

Stimulating the client base of large commercial firms to explore alternative billing methods is therefore likely to be an effective means of accelerating a movement away from time billing. Consideration should be given to involving representatives of the commercial enterprises who use the larger firms in programmes intended to examine alternative billing practices.

PROFESSIONAL EDUCATION AND COMPETENCY DEVELOPMENT

If the changes to the disclosure and billing regimes recommended in this paper are implemented, there will need to be an appropriate education and information campaign among practitioners to support compliance with their requirements. This is the minimum necessary.

A more comprehensive approach to education, particularly one which addresses the development of business and project management competencies, would be of more long-term use. Education programmes which draw attention to the benefits of more transparent relationships and greater variety in commercial pricing structures would also contribute to professional cultural change.

The focus of any education strategy should be on admitted practitioners rather than undergraduates or practical legal training students. Although it is essential that these groups thoroughly understand the need for ethical practice, and develop sound communications and interpersonal skills, they will not be in positions of influence for some considerable time and in the meantime will be under considerable pressure to adopt current professional cultural norms.

In New South Wales, post admission continuing legal education (CLE) falls into several categories:

- Practice management courses required for practitioners wishing to move from a restricted practising certificate to an unrestricted one:
- Mandatory Continuing Legal Education (MCLE), being 10 hours of training in subjects of the practitioner's choosing each year:
- Compulsory units of MCLE, being seminars on particular subjects which are required to be undertaken by every practitioner, pursuant to regulation 69B of the Legal Profession Regulations. These units cover equal opportunity, unlawful discrimination and occupational health and safety, and must be undertaken at least once every three years.

Hundreds of CLE courses are offered each year, by a range of commercial providers as well as the Law Society, the Bar Association and LawCover.

A number of those who responded to the Discussion Paper supported increased CLE training in areas such as charging and billing practices,¹⁰³ communications skills¹⁰⁴ and or risk management..¹⁰⁵ Further, non-time-

¹⁰³ Penhall-Jones, *Submission*, p 2

¹⁰⁴ Madden, *Slater & Gordon Submission*, p 7; Walker, *IMF(Australia) Submission*, p 5; Law Society, *Submission*, p 10

based billing requires confidence and skill in assessing risk, and running budget-based matters requires competence in project management. The acceptance of budgets in particular would be jeopardised if lawyers only learn the necessary project management skills on the job, i.e. from mistakes made at the expense of their clients' interests

These competencies are not presently addressed in pre-admission legal training and are rarely the subject of CLE. The St James Ethics Centre has for several years organised an annual lecture on legal ethics, and Law Cover regularly provides courses on risk management. The Law Society recently held its inaugural ethics seminar. As at the date of this paper, a review of the websites of some major CLE providers, (including the College of Law, University of Sydney, UTS/The CLE Centre, LexisNexis, The Law Society and Legalwise Seminars) found only a handful of offerings (out of literally hundreds of courses) on subjects related to professional regulation and practice management skills (other than risk management), and none on communication skills (other than legal writing) or professional ethics.

The Bar Association currently requires all practising barristers to complete one unit (i.e. one hour) of CLE in the area of ethics and professional regulation each year, and provides seminars on these subjects. There is no such requirement for solicitors. It is probably true that the only training in professional regulation or ethics undertaken by most solicitors in this state is that provided compulsorily (in undergraduate courses, initial practical legal training courses and the practice management course required to be undertaken prior to issue of an unrestricted practising certificate) or programmes offered in-house by individual (usually large) firms.

While courses in communication skills, compulsory disclosure, risk management and project management skills can be developed, and existing courses in the area expanded, a significant problem remains with the self-selecting nature of CLE. There is no guarantee that those practitioners who need the training will choose to attend it. Indeed in as far as the need arises from a lack of insight and or inadequate practice management skills, problem practitioners may well be the least likely to perceive themselves as needing assistance. If recent experience is an indicator, there is also a lack of overall interest by the profession in this state in taking part in formal ethics-based CLE: a half day programme offered in 2004 by the promoters of the State Legal Conference attracted only ten participants in response to the distribution of over 6,000 invitations.

The Discussion Paper asked whether practitioners remiss in their obligations in relation to proper billing should be required to undertake further education on the subject. There was support from submitters for this proposal, including for its expansion into a disciplinary outcome:

¹⁰⁵ Young Lawyers, *Submission*, p3

Compulsory participation in CLE would be a suitable alternative to other penalties, where a finding of professional misconduct or unsatisfactory professional conduct is entered under the existing rules.¹⁰⁶

Section 562(4)(c) of the 2004 Act permits the Tribunal to order a practitioner to undertake and complete a specified course of further legal education. The Commissioner and the Councils have no such specific power, but as a matter of practice may be able to obtain appropriate undertakings as part of a negotiated settlement of an investigation.

Most of the matters which come by way of complaint to the OLSC, and to the professional societies, do not end up in the Tribunal. A considerable number result in findings of unsatisfactory professional conduct and consequent reprimands (presently private reprimands). There is also a small but significant number of practitioners who have accumulated multiple reprimands.

Punishment of itself is not always sufficient to prevent further unacceptable conduct. The very real possibility exists that these practitioners lack either or both of the insight to identify the source of the problem behaviour and the skill necessary to change it. In many of these cases further complaints, including the expense of Tribunal proceedings, may be able to be avoided if the practitioner undertook an appropriate course of training. Consideration should be given to formally permitting the Commissioner and/or the Councils, as part of a decision to reprimand a practitioner, to direct that he or she undertake further education and to refuse to renew the practitioner's practising certificate until it has been completed.

While compulsory training would be a considerable asset to the regulatory armoury, since it addresses and seeks to correct the patterns of behaviour which underlie and generate complaints, in New South Wales there are presently no appropriate courses to which a practitioner in this situation could be directed.

Several jurisdictions in North America conduct annual "Ethics School" training programmes, which provide intensive training in matters of professional conduct and ethical responsibilities. Attendance counts for CLE requirements, and attendees fall into three main categories:

- Those who volunteer, out of personal interest or as a result of a self diagnosed problem;
- Those recommended to attend by the regulator or professional governing body, in response to concerns about gaps in the practitioner's competency base; or
- Those directed to attend by the regulator or disciplinary tribunal as part of a formal sanction for disciplinary breach.

¹⁰⁶ Australian Lawyers' Alliance, *Submission*, p 6

It would be beneficial if an annual Ethics Programme were to be established in New South Wales. To be effective it would need to involve a concentrated series of activities and courses, over an intensive period. It should require active participation and assessment, and not be based on mere passive attendance at lecture-based seminars. In line with the evidence from the OLSC's complaints experience, the Ethics Programme should focus strongly on communications competencies, particularly in relation to compulsory disclosures. Options in practice management and project management skills should also be offered.

Those who submitted responses to the Discussion Paper were less inclined to endorse the development of training in alternative billing methods than they were in relation to communication skills, with some seeing the issue of billing as being a matter of business practice rather than education.¹⁰⁷ Given that lawyers themselves show little discomfort with the current arrangements, and particularly in light of this response, it appears that training only on alternative billing methods would be likely to meet with resistance or at least only moderate support.

¹⁰⁷ Madden, *Slater & Gordon Submission*, p7..