

# Competition in professions

A report by the Director General  
of Fair Trading

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# **REPORT ON COMPETITION IN PROFESSIONS**

## **A REPORT BY THE DIRECTOR GENERAL OF FAIR TRADING**

### **PREFACE**

This report follows a review of restrictions on competition in professions conducted by the Office of Fair Trading. The review was conducted under section 2 of the Fair Trading Act. Enclosed with my report is the report of consultants LECG who were commissioned by my predecessor John Bridgeman. I am grateful to LECG for the work that they have done. John Bridgeman fixed their terms of reference but subject to those confines their report is their own responsibility. Any views expressed in LECG's report are those of the authors: they do not necessarily reflect OFT's views. These are expressed in my report, which was written with the benefit of having seen that of LECG. Where appropriate, and to avoid duplication, my report cross-refers to that of LECG and should be read with it. My report is not and should not be treated as a guideline issued as a consequence of the obligation to publish general advice and information under the Competition Act 1998.

**John Vickers**  
**Director General of Fair Trading**

# CONTENTS

<i>Section</i>		<i>Page</i>
I	Introduction	1
II	Terms of reference	2
III	Competition and regulation	2
IV	How we set about the task	3
V	LECG report	3
VI	General themes from previous scrutiny	4
VII	LECG's conclusions	5
VIII	Restrictions on entry	6
IX	Restrictions on conduct	7
X	Restrictions on methods of supply	7
XI	OFT powers with regard to professional rules	8
XII	Schedule 4, CA98	10
XIII	Restrictions not primarily based on professional rules	11
	<i>Solicitors and barristers</i>	11
	<i>Accountancy</i>	12
XIV	Restrictions based on professional rules	12
	<i>Solicitors</i>	13
	<i>Barristers</i>	14
	<i>Accountancy</i>	16
	<i>Architecture</i>	16
XV	Fuller implementation of existing legislation	17
	<i>Solicitors</i>	17
XVI	Further work	18
	<i>Insolvency practitioners</i>	18
XVII	Conclusion	19

## I INTRODUCTION

1. The professions are entrusted with the delivery of services of considerable public importance. They work within a framework of law, but within that framework their governing bodies have important degrees of freedom to control rights to enter and practise the relevant professions. The exercise of these powers can have a significant impact on the economy, on the interests of consumers, and on society generally, especially where the professions concerned have exclusive rights to supply certain services. Restrictions on supply in the case of professional services, just as with other goods and services, will tend to drive up costs and prices, limit access and choice and cause customers to receive poorer value for money than they would under properly competitive conditions. Such restrictions will tend also to inhibit innovation in the supply of services, again to the ultimate detriment of the public.
2. Restrictions may be justified under competition law if they are in the public interest, if they serve economic progress, if the benefits are shared with consumers and if the restrictions do not go further than is necessary or eliminate competition. However, where they go beyond these boundaries, it is important that the competition authorities should be able to take action to free the forces of competition.
3. Needless to say, these are perennial concerns relating to the professions and have been considered frequently in the past, both by the competition authorities and by sponsor departments. To some degree the rules, practices and customs of the professions have changed over time in response to these concerns. We have studied these evolutionary changes in our review. Some progress has been achieved but significant restrictions remain which may very well not be justified. This review does not, however, aim to complete this analysis definitively. In keeping with its remit, it concentrates on identifying restrictions that appear to have significant anti-competitive effects. In the professions, as elsewhere, there should be a presumption that such restrictions should go. But this is a rebuttable presumption, and this review has not sought to examine, case by case and in detail, the strength of the arguments for rebuttal. That is a task for later analysis.
4. An important principle should however be stated at the outset. At no point does this report prescribe, even tentatively, how professional services should be supplied. How goods and services are supplied is generally best determined by unfettered competition between producers for the custom of consumers. In most markets, the patterns of supply which emerge from this process are healthily unpredictable, mixed, and evolve over time. But in the professions there remain restrictions on competition which do, in effect, prescribe how services should be supplied. In assessing whether such restrictions should be permitted to remain, the onus of proof should be on the proponents of the restriction. So the aim of this report is not just to identify questions for further analysis. It is to **challenge** restrictions on freedoms to compete. Those freedoms are rightly regarded as the norm in economic activities generally.

## II TERMS OF REFERENCE

5. This review of restrictions on competition in the professions in England and Wales<sup>1</sup> was announced in the 1999 pre-Budget Report. Its terms of reference were given in the *Economic and Fiscal Strategy Report* published with the Chancellor's Budget for 2000. It has been carried out under section 2 of the Fair Trading Act 1973 (FTA). The aim of the review was to identify restrictions, whether arising from law, professional rule or other source, which had the effect of preventing, restricting or distorting competition in professional services to a significant extent. It was to identify any consumer benefits claimed for the restrictions, but to leave for further consideration whether these benefits justified the restrictions. After considering responses to a consultation document, my predecessor, John Bridgeman, decided that the review should cover lawyers, accountants, and architects.

## III COMPETITION AND REGULATION

6. Markets generally work best for consumers when there is
- unrestricted competition between existing suppliers, and
  - unrestricted potential competition from new suppliers and from new forms of supply.
7. In markets for professional services there are numerous restrictions on what existing suppliers can do, on who can supply, and on allowed forms of supply. These restrictions stem from statute, from rules set by the professional bodies, and from custom and practice.
8. The rationale for regulating professions is that their customers, or consumers, are generally not in a position to assess the quality of the professional services they buy. By the very nature of professional services there is an asymmetry of information between suppliers and consumers. In order to protect consumers from exploitation of their position of relative weakness, some restrictions on supply may be justified. For the purposes of the review, these may be broken down into three categories of restrictions on:
- entry to a profession, including indirect restrictions through limiting the permissible structures within which professionals may provide their services;
  - members' conduct; and
  - demarcation, limiting how far members of one profession should be allowed to compete in offering services usually supplied by members of another (or another part of the same profession).

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<sup>1</sup> While the OFT's competition responsibilities extend to the whole of the UK, under the Scotland Act 1998 competition issues in the provision of legal services in Scotland are a matter for the Scottish Executive. Partly for this reason and partly in the interests of a sharper focus, the study was confined to England and Wales.

9. The concern underlying this review is that, particularly where the restrictions are imposed by professions regulating themselves, there are no guarantees:
- that the restrictions on competition are the minimum necessary to achieve goals of consumer protection; or
  - that they maximise overall consumer benefit by striking the right balance between consumer benefits from competition and from protection.
10. Indeed, the professions are run by producers largely on behalf of producers. In the economy generally it is competition that impels producers to act in the interests of consumers. Restrictions on competition – on the freedom of suppliers of services to compete with one another – imposed by professions should therefore be subject to close and careful scrutiny.
11. The aim of the Office of Fair Trading (OFT) is to make sure that markets work well – for the ultimate benefit of consumers. To that end, we have examined restrictions on competition in the professions selected. The aim has been to identify significant adverse effects on competition. We have not examined in detail whether or not every particular adverse effect on competition is justified by countervailing consumer benefits that could not otherwise be achieved. But where restrictions are causing significant adverse effects on competition, from a policy perspective, they should be removed unless their proponents can demonstrate strong justifications for them in terms of consumer benefit. In any event, the professions should not be shielded from the competition laws that apply elsewhere in the economy.

#### **IV HOW WE SET ABOUT THE TASK**

12. The OFT published a consultation paper in May 2000, discussing the issues in depth and raising questions about regulation and competition. The consultation paper was sent to a range of professional bodies, industry representatives, leading firms, consumer groups, and independent experts and opinion-formers. It was made available on the OFT's website. In the light of responses, the list of professions and rules for closer scrutiny was narrowed down. The OFT then selected as consultants Law and Economics Consulting Group (LECG), who began work in July.

#### **V LECG REPORT**

13. LECG built on the OFT's own consultation with a series of questionnaires addressed to professional bodies, firms, customer representatives, regulators in sponsor government departments and independent experts. They followed these questionnaires with a thorough programme of interviews, and then analysed the results and prepared a detailed report to the OFT, which accompanies this report. LECG gave the relevant professional bodies an opportunity to comment on a brief outline of their principal emerging findings before submitting the report.

## VI GENERAL THEMES FROM PREVIOUS SCRUTINY

14. Part of LECG's task was to survey past reviews by the competition authorities and action by the government departments sponsoring the professions concerned. The relevant Departments are the Department of Trade and Industry in the case of accountants, the Lord Chancellor's Department in the case of the legal professions, and the Department of Environment, Transport and the Regions in the case of architects.
15. The last ten years or so have seen significant policy developments, in particular in relation to the accountancy and legal professions. The governance of the accountancy professions has been reformed, introducing an important lay element.
16. The statutory monopolies that solicitors previously enjoyed over conveyancing and rights to conduct litigation, and that barristers enjoyed over rights of audience in the higher courts, have been removed. LECG took account of these developments in reviewing the remaining market power of these professions and remaining restrictions.
17. My predecessors exercised their powers under the FTA on several occasions to report on the rules and conduct of professional bodies and their members, and to make references to the Monopolies and Mergers Commission<sup>2</sup> (now the Competition Commission). This work is summarised in LECG's report. It has had three main themes:
  - price competition;
  - advertising; and
  - the kinds of business organisation through which the members of professions are free to provide their services.
18. Nothing is more essential to effective competition than freedom to compete on price. Historically, there have been many instances of attempts by professional bodies to mute such competition by prescribing fees to be charged for specified services. Mandatory fee scales have generally been considered by the OFT and the Monopolies and Mergers Commission to be significant restrictions on competition that are manifestly contrary to the public interest. Advisory fee scales, where charges are objectively determined and reflect changing market conditions and the parties are free to negotiate, may in some circumstances be acceptable, but these conditions are hard to satisfy. This review examines two advisory scales: the RIBA scale, in use by architects, and the guidance issued to solicitors in relation to non-contentious work such as probate.

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<sup>2</sup> In all, professional rules have been referred to the Monopolies and Mergers Commission on 14 occasions. Nine of these references related to restrictions on advertising, three related to fee scales and charges and two addressed the rules relating to the provision of advocacy services by senior counsel. In some other instances negotiation rather than referral led to the withdrawal by professions of rules or practices which were considered to be anti-competitive.



19. Freedom to advertise is another key element of competition, so that suppliers can inform potential customers about services offered and their terms, so assisting consumer choice. Historically, many professions have restricted advertising tightly. Although various arguments were advanced to support these restrictions, it was plain that they restricted competition disproportionately. As a result of the OFT initiatives and subsequent MMC reports and Ministerial action mentioned above, there has been considerable liberalisation of advertising across a wide range of professions. Advertising of professional services is now generally permitted, subject to limitations in relation to advertising which is held to be misleading or harmful to the reputation of the profession. However, the review has drawn attention to some remaining restrictions that are open to question.
20. The kinds of business organisation through which members of a profession are free to provide their services have wide-ranging implications for the efficiency with which professional services are supplied, for innovation in supply, and for the risks and incentives faced by professionals. They bear on the attractiveness of a profession to potential entrants, on the ability of new entrants to raise the necessary capital for entry and on the behaviour of members of the profession. For example, sole practitioners face different conditions from members of a partnership, who in turn face different conditions from directors and employees of a company. The implications go beyond economic considerations. Improving access to professions should also enhance equality of opportunity and hence diversity.
21. In a 1986 report known as the *Entities Report*,<sup>3</sup> the then Director General of Fair Trading expressed the view that it was desirable, in principle, to permit the formation of multi-disciplinary practices (MDPs). He advocated that the existing statutory bars on such partnerships should be lifted. Although some progress has been made on this front, some regulatory restrictions remain, along with restrictions in the rules of a number of professions.

## VII LECG'S CONCLUSIONS

22. LECG attempted to compile information on the economic importance of professional services that are the subject of this review; on structure, including number of competitors and entry barriers; and on trends in fee income. They were handicapped by shortage of published information but their analysis is useful background to judgments on the wider significance of the effects of restrictions.
23. Generally speaking, although LECG have found certain areas of concentration of supply in the hands of a few firms or groups of practitioners that could lead to concern, they have not found evidence of cartel activity among the professions they examined.<sup>4</sup> Were OFT to receive such evidence, we would of course be able to use powers under the Competition Act 1998 (CA98) to investigate and, if appropriate, impose penalties. However, LECG have identified a number of restrictive regulations and rules that are of concern.

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<sup>3</sup> 1986 Report by the Director General of Fair Trading on restrictions on the kind of organisation through which members of the professions may provide their services.

<sup>4</sup> LECG report paras 130-140 (solicitors), 228-234 and 297 (barristers), 302-6 (accountants) and 365-6 (architects).

24. LECG identify restrictions that in their opinion have significant effects on competition, but in line with their remit do not go on to assess whether claimed public interest benefits can be shown to outweigh this detriment. This assessment is a matter for the competent authorities. Where competition law applies – and I return below to the issue of exclusion for designated professional rules and other exclusions which may prevent the application of the CA98 – the Director General of Fair Trading or the Secretary of State in the light of a report by the Competition Commission on a reference would be able to assess this balance and use the powers in the CA98 or the FTA. These include powers to impose financial penalties, or to order changes, or to negotiate amendments with the bodies concerned, where they are open to such an approach.<sup>5</sup>
25. While the majority of the restrictions identified have their origin in professional rules or codes of conduct, this is not true of all of them.<sup>6</sup> For example, the distinction between Queen’s Counsel (QCs) and junior barristers, which appears to distort competition, has its origin in the power of the Lord Chancellor to recommend candidates for appointment as QCs to the monarch, reinforced by custom and practice. Professional rules governing the conduct, etc of QCs are secondary to this underlying process, and where changes in the process are desirable this is a policy matter for the decision of Government.
26. A number of common themes emerge from our consultants’ review of the three professions. It is useful to highlight these before turning to individual restrictions.

## VIII RESTRICTIONS ON ENTRY

27. The openness of markets to new entrants is important to effective competition. This does not mean that requirements to pass a test or pay a subscription are never permissible under competition law. A requirement to have demonstrated basic competence is clearly justified where consumers are not well placed to assess the quality of service, as is usually the case in markets for professional services. Provided that necessary qualification thresholds are not manipulated to limit supply and force up price, there will not be a significant adverse effect on competition. This proviso cannot lightly be assumed to be met, however. There is a straightforward pecuniary incentive for incumbent producers, who largely control the professional bodies, to constrain entry below the level that would most benefit the public generally.<sup>7</sup> In relation to each of the professions selected for this review, however, LECG did not find evidence that current entry qualifications and continuous professional development requirements are themselves having significant undue restrictive effects.

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<sup>5</sup> This may, for example be the case for a number of the restrictions found to stem from the Law Society’s Practice Rules, amendment of which is already being discussed by the Law Society. See *Financial Times*, 2 January 2001, page 1.

<sup>6</sup> See Annex D to LECG’s report for a table that identifies the origin of each restriction identified.

<sup>7</sup> See Shaked, Avner and Sutton, John (1981) ‘The Self-Regulating Profession’, *Review of Economic Studies*, 47, 217-234.

## **IX RESTRICTIONS ON CONDUCT**

28. Among restrictions on conduct, restrictions on pricing are potentially highly damaging for competition. As a result of past initiatives, mandatory fee scales in the professions have all but disappeared. However a number of professions still have recommended fee scales. The RIBA fee scale and the guidance issued by solicitors on probate work have been examined in the course of the review. While many restrictions upon advertising have already been abandoned by the professions, often following investigation by the OFT, the review highlights that some restrictions on advertising remain and that these continue to affect competition adversely.

## **X RESTRICTIONS ON METHODS OF SUPPLY**

29. Related to the question of entry restrictions is the question of restrictions on methods of supply. Our review has identified several such restrictions as having significant adverse effects. Among these are the Bar's sole practice rules; Bar rules which restrict direct access to barristers; the 50% rule on the control of partnerships providing auditing services; and several restrictions inhibiting the formation of multi-disciplinary partnerships (MDPs).
30. A number of the restrictions identified are linked by the effect that they have upon the formation of MDPs. We have generally concluded that rules that prevent the establishment of MDPs restrict competition. For example they inhibit the formation of fully integrated practices bringing together accountants and lawyers; integrated property services practices that might involve surveyors; estate agents and solicitors; and financial services practices that might involve financial advisers in partnership with accountants and solicitors.
31. These restrictions on MDPs may inhibit new entry and prevent the exploitation of possible economies of scale and scope. MDPs might achieve advantages in branding, overhead cost savings, and the ability to transfer resources in response to fluctuations in demand and to give a seamless service to clients. While these advantages may benefit firms of all sizes, they are likely to be especially marked at the level of the high-street firm. The opportunity to provide combinations of high-street professional services under one roof should unlock potential cost efficiencies and enhance customer choice and convenience at this level of the market.
32. Since the *Entities Report* in 1986, the OFT has favoured lifting restrictions on MDPs where these unnecessarily restrict competition. That report recommended that the Solicitors Act 1974 be amended to remove statutory barriers to fee sharing by solicitors as a necessary step before the practice rules of the Law Society could be changed. Section 66 of the Courts and Legal Services Act 1990 achieved this by removing the statutory prohibition in section 39 of the Solicitors Act 1974. It also declared that no rule of common law would prevent barristers from entering into unincorporated association with non-barristers. Remaining restrictions upon lawyers taking part in MDPs are therefore to be found in professional rules.

## XI OFT POWERS WITH REGARD TO PROFESSIONAL RULES

33. The principal competition statutes are the Competition Act 1998 (CA98) and the Fair Trading Act 1973 (FTA). Both apply to the professions, subject to significant limitations in the case of the CA98. The Companies Act 1989 and the Courts and Legal Services Act 1990 (CLSA) also give the Director General specific advisory functions in relation to certain professional rules (respectively, auditors' rules and rules relating to rights of audience and rights to conduct litigation) over which Ministers have powers of veto.
34. In addition to applicable national law, European Community competition law is applicable to anti-competitive agreements and abuses of a dominant position in the professions where these may affect trade between EU member states.
35. The CA98 contains two prohibitions.<sup>8</sup> The Chapter I prohibition applies to agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the UK or any part of it and which have as their object or effect the prevention, restriction or distortion of competition within the UK. The Chapter II prohibition applies to conduct on the part of one or more undertakings that amounts to the abuse of a dominant position in a market and which may affect trade within the UK or any part of it.
36. There is no possibility of an exemption from the Chapter II prohibition: conduct by an undertaking which is in a dominant position is either abusive or it is not.<sup>9</sup> Activity that falls within the Chapter I prohibition may qualify for exemption if it meets the relevant criteria.<sup>10</sup> The CA98 sets out at section 9 the criteria that must be met if an individual or block exemption is to be granted. The criteria are that the agreement:
- (a) contributes to
    - (i) improving production or distribution, or
    - (ii) promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit; but

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<sup>8</sup> For a more detailed summary of the CA98 provisions see OFT Competition Act guideline *The Major Provisions*. For a fuller account of the application of the Competition Act to the professions, see OFT Competition Act guideline *Trade Associations, Professions and Self-Regulating Bodies*. The guidelines can be accessed through the OFT's web site [www.offt.gov.uk](http://www.offt.gov.uk).

<sup>9</sup> In certain circumstances provided by the CA98, such conduct may, however, be excluded from the scope of the prohibition altogether. See the discussion of the exclusion in schedule 3, paragraph 5 of the CA98 in paragraphs 38 and 40.

<sup>10</sup> There are three types of exemption: 1) individual exemptions, which may be granted for individual agreements where these are notified; 2) block exemptions, which apply automatically to certain categories of agreement; and 3) parallel exemptions, which apply where an agreement is covered by an EC exemption, individual or block, or would be covered by such an exemption if the agreement had an effect on trade between member states of the European Union. For more detailed information on exemptions see OFT guideline *The Chapter I Prohibition*. This can be accessed through the OFT's web site [www.offt.gov.uk](http://www.offt.gov.uk).

- (b) does not
  - (i) impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or
  - (ii) afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.<sup>11</sup>
- 37. It will be apparent that section 9 allows the balancing of competition and other consumer protection arguments, reflecting the fact that competition is a means to an end and not an end in itself. This balance is fundamental to the application of competition law to professional regulation.
- 38. The CA98 provides for a number of exclusions that may limit the application of the CA98 in the case of professional rules. Of particular significance is the exclusion in Schedule 4 which is specific to professional rules and which may operate to exclude professional rules from the scope of the Chapter I prohibition. Also of importance is the exclusion in Schedule 3 paragraph 5 which is general in application, but which may have the effect of excluding certain professional rules or conduct from the scope of both of the Act's prohibitions. There are important differences in the manner in which the two exclusions take effect.
- 39. Schedule 4 establishes a procedure enabling selected professions specified in this Schedule to apply to the Secretary of State for Trade and Industry to have rules designated. To the extent to which an agreement constituted a designated professional rule, imposed obligations arising from such a rule, or constituted an agreement to act in accordance with such rules, the Chapter I prohibition would not apply to the agreement. It should be noted, however, that under Schedule 4, the Director General has a duty to review any rules so designated and, where appropriate, to advise the Secretary of State to revoke the designation.
- 40. Schedule 3 paragraph 5 provides that the Chapter I prohibition does not apply to an agreement to the extent to which it is made in order to comply with a legal requirement. The Schedule also provides that the Chapter II prohibition does not apply to conduct to the extent to which it is engaged in in order to comply with a legal requirement. Exclusion is not, in this case, subsequent to a process of designation, but takes effect automatically where the conditions in the Schedule are met.
- 41. Under section 2 of the FTA, the Director General of Fair Trading has a general duty to keep under review the carrying on of commercial activities in the UK, so that he may become aware of, and ascertain the circumstances relating to, monopoly situations and uncompetitive practices. In the context of the professions, the provisions of the FTA that deal with complex monopolies<sup>12</sup> are the most likely to be relevant. Where

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<sup>11</sup> For an explanation of the exemption criteria see OFT guideline *The Chapter I Prohibition* paras 4.10 - 4.16. This can be accessed through the OFT's web site [www.offt.gov.uk](http://www.offt.gov.uk).

<sup>12</sup> A complex monopoly situation exists where two or more persons who are not a group of interconnected bodies corporate, and who together account for at least one quarter of the supply of any particular description of goods or services in all or part of the UK, engage in conduct which in any way prevents, restricts or distorts competition in connection with the supply of those goods or services.

it appears to the Director General that a monopoly exists, he can make a reference to the Competition Commission. The Competition Commission must then report to the Secretary of State its findings as to whether or not a monopoly exists and, if so, whether it is operating or may be expected to operate against the public interest. Following an adverse finding, responsibility for deciding on remedies then lies with the Secretary of State with the advice of the Director General. Where there has been an adverse finding, the Secretary of State can make an order or invite the Director General to seek undertakings from the parties. The complex monopoly provisions may catch activities which are not caught by the CA98 provisions: where, for example, a set of independent professional practitioners or partnerships all adopt similar practices or engage in parallel behaviour which appears to be anti-competitive, but there is no explicit collusion or agreement or rule binding them to do so.

42. Several of the restrictions highlighted in LECG's report stem from sources other than professional rules. This report will deal with these after first discussing LECG's recommendation, which I support, that the provisions in the CA98 to designate particular professional rules for exclusion should be repealed. Then the report will discuss restrictions based on professional rules.

## **XII SCHEDULE 4, CA98<sup>13</sup>**

43. LECG recommends that the procedure entitling specified professions to seek exclusion by designation as described above should be removed. No profession has yet applied for designation of any of its rules. However, if any did, designation would in effect be automatic. Although Schedule 4 does provide a mechanism by which designation may be revoked, the procedure appears cumbersome. Moreover, the fact that rules were designated and were excluded from the application of the prohibition would mean that any parties otherwise in breach of Chapter I prohibition were not – while the rule remained designated – liable to penalties for breach.<sup>14</sup> Penalties, in accordance with the guidance<sup>15</sup> would apply only once the rules were actually in breach of the prohibition, and the period during which the rules had been designated would be left out of account in determining the duration of the infringement. In addition, while a rule is excluded, it is not open to a private litigant to launch a suit under the Chapter I prohibition of the CA98 for damages suffered as a consequence of the restriction, and to argue that a court should rule the restriction void. All this weakens the incentives, which generally exist elsewhere in the economy, not to engage in anti-competitive activity.

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<sup>13</sup> LECG report paras 434-435; para.13 and para. 107.

<sup>14</sup> CA98 section 36 provides that the Director General may require an undertaking which is found to have infringed one of the prohibitions under the CA98 to pay a financial penalty. Under CA98 section 38(1), the Director General must prepare and publish guidance as to the appropriate amount of such a penalty. In setting the amount of the penalty, the Director General must have regard to the guidance (section 38(8)).

<sup>15</sup> See OFT publication *Director General of Fair Trading's Guidance as to the Appropriate Amount of a Penalty*. The guidance can be accessed through the OFT's web site [www.offt.gov.uk](http://www.offt.gov.uk).

44. The exclusion procedure has no equivalent in European Community competition law, on which the main provisions of the CA98 are modelled. It is of course a policy question for the Secretary of State for Trade and Industry, but in my view, there is a strong case for removing Schedule 4.

### **XIII RESTRICTIONS NOT PRIMARILY BASED ON PROFESSIONAL RULES**

#### **Solicitors and barristers**

##### **QC system<sup>16</sup>**

45. It is right to recognise first that some of the old restrictions surrounding the conduct of QCs have been removed some time ago. For example, it is now no longer obligatory for a QC to be supported by a junior barrister. However, other restrictions both in rules and in custom and practice relating to this distinction persist, and have significant effects on competition. The Lord Chancellor, in 1999, commissioned a report from Sir Leonard Peach on the selection of QCs, which in general found that the selection of QCs was made after appropriate consideration. The report nonetheless made a number of recommendations, the implementation of which has resulted in improved transparency and objectivity in the selection process. New features of the process include the opportunity for unsuccessful applicants to receive feedback on their applications, safeguards against discrimination, and provision for the process to be scrutinised by the Commissioner for Judicial Appointments.
46. That report did not however address the fundamental issue of whether, given that the historical origins of the title no longer correspond to its function, it was right for the Government to have responsibility for conferring on selected practitioners in a profession a title that manifestly enhances their earning power and competitive position relative to others. There remain concerns also that there is no continuous quality appraisal to ensure that the quality mark of QC remains justified, that there is inadequate peer review on selection and that there are no professional examinations that must be taken in order to become a QC (although this latter point was a recommendation of the *Peach Report*). In any event, even if it could be shown that such an appointment system were transparent, objective and non-discriminatory, and operated as a genuine quality mark, it is difficult to understand the client's need for a quality mark where restrictions upon direct access by clients to barristers remain in place and barristers' services are consequently purchased by solicitors who are specialists. Given these considerations, it is questionable what the value of the system is to consumers.

##### **Legal professional privilege<sup>17</sup>**

47. Legal professional privilege has its origin in case law and is recognised in European law. Clearly there are fundamental arguments for protecting the exchanges between clients and their legal advisers. However, where the subject of these exchanges is advice that could equally be provided by a member of another profession, there is a case on efficiency and competition grounds for either a reduction in the scope of the privilege of legal advisers or a limited extension of privilege to others in order to

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<sup>16</sup> LECG report paras 270-279 and para. 443.

<sup>17</sup> LECG report paras 187-190 and para. 440.

remove the distortion of competition that favours the lawyer. The example raised in the course of the review is tax advice, where accountants feel themselves at a disadvantage to lawyers. The CLSA, section 63, provides a useful precedent for the extension of legal professional privilege to new types of professional where they provide services in competition with lawyers. This reform was limited to advocacy, litigation, conveyancing and probate services, but might be used as a model for further statutory amendment in order to extend privilege to specified services provided by other professionals in defined circumstances. However, the possible wider consequences beyond competition considerations of the precedent created by such a move would need to be carefully weighed.

## Accountancy

### **The 50% rule**<sup>18</sup>

48. This restricts statutory audit to those who practise in a firm in which qualified individuals hold the majority of voting rights. The restriction is embodied in the Companies Act 1989 Schedule 11, Part II, para 4(1)(b), which in turn enacts a provision of the Eighth EC Company Law Directive. To relax the restriction would require amendment of UK and European law, the latter obviously being a matter over which the UK Government does not have sole control. Representatives of the *Institute of Chartered Accountants in England and Wales (ICAEW)* have shown a willingness to discuss change as have a number of the larger accountancy firms. In taking any decision it will be necessary to balance the public interest benefit from the maintenance of auditor independence – bearing in mind that the ‘consumer’ of audit services is the public and not just the business paying for its audit – with the efficiency gains that would result from MDPs.<sup>19</sup>

## XIV RESTRICTIONS BASED ON PROFESSIONAL RULES

49. The dual structure of the legal profession itself, with its separate roles for solicitors and barristers, may add unnecessarily to costs. This is not addressed in LECG’s report. Government reforms have addressed this issue indirectly, by gradually opening the way for each branch of the profession to be authorised to do the work of the other. But there is some way to go. In my view, rather than pressing now for restructuring to end the dual structure of the legal profession, the best approach is to address its remaining adverse effects through further liberalisation of professional rules mentioned below.

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<sup>18</sup> LECG report paras 319-326 and para. 447.

<sup>19</sup> Recent amendments (November 2000) to the Securities and Exchange Commission’s (SEC) rules on auditor independence appears to reduce, while not altogether removing, the obstacle which the SEC rules pose to MDPs involving auditors.



50. Some of the other restrictions identified by LECG are articulated in professional rules that could be investigated under the CA98, provided they were not designated or otherwise outside the jurisdiction of that Act, or could be referred to the Competition Commission using the complex monopoly provisions of the FTA. In the case of certain other restrictions, there are specific powers for competition review in other statutes such as the CLSA and the Companies Act 1989 that could be used. Where the legislation leaves no provision for competition review, then I recommend that Ministers consider the case for amending the relevant legislation. Some of the restrictions highlighted here are located in professional rules which are already the subject of review by the relevant profession. These initiatives are very welcome and will, it is hoped, lead to the prompt removal of unjustified restrictions. In the case of other restrictive rules in respect of which no such initiative has yet been taken, the professional bodies concerned are strongly encouraged to review rules highlighted by this report, and to take prompt action to remove these where they do not have a proper justification. Where professions display a willingness to make necessary changes within a reasonable time, further intervention by the OFT will be deferred. Where that willingness is absent or where restrictions continue to have significant effects on competition without adequate justification, the OFT will use its available powers with a view to removal of those restrictions. In any event, use of those powers, where necessary, will not be deferred for more than a year from now.

## Solicitors

### Indirect entry restrictions

- Restrictions on MDPs (Solicitors' Practice Rules 4 and 7).<sup>20</sup>

I welcome the fact that the Law Society is currently at an advanced stage in considering proposals for liberalisation. I look for progress on this within 12 months.

- Restrictions on employed solicitors acting for third parties (Employed Solicitors' Code 1990 and Solicitors' Practice Rule 4).<sup>21</sup>

Solicitors who are employed by non-solicitors may act 'as solicitors' only for their employers and not for any other persons. This rule applies to services of the type normally reserved to solicitors, for example legal advice, advocacy and probate work. Removal of the rule could allow competition from those suitably-qualified working in different business structures. Concerns about regulating solicitors employed by non-solicitors could be met by a system where individual practitioners rather than business structures were regulated.

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<sup>20</sup> LECG report paras 441 and 319 - 326.

<sup>21</sup> LECG report paras 440(iv) and 191 - 194.

## Conduct

- Advertising restrictions (Solicitors' Publicity Code).<sup>22</sup>

The Law Society imposes some restrictions on fee advertising. Most notably it prohibits the seeking of business by telephone from potential clients (sometimes referred to pejoratively as 'cold-calling') and comparative fee advertising. Removal of these restrictions could enable small firms to compete more effectively and would help prospective clients to evaluate relative value for money. There is some indication that the Law Society may itself abolish these two restrictions.<sup>23</sup> Again, I welcome this but look for progress within 12 months.

- Restrictions on receiving a payment for referring a client (Solicitors' Practice Rule 3).<sup>24</sup>

The current regime also prevents solicitors from making payments for work that is referred to them by a third party. This may be hampering inter alia the development of an online marketplace that could bring clients and solicitors together. As with advertising restrictions, there are welcome indications that this restriction may be abolished.<sup>25</sup>

- Fee guidance:

This is guidance issued by the Law Society regarding fees to be charged for certain types of work. It is indirectly based upon the Solicitors (Non-Contentious Business) Remuneration Order 1995.<sup>26</sup> In relation to probate work in particular, the fee guidance issued may inhibit or distort price competition.

## Barristers

### Indirect entry restrictions

- Restrictions on permitted business structures.<sup>27</sup>

The Bar Council Code of Conduct prevents barristers from forming partnerships with one another and with members of other professions. Employed barristers have only very limited rights to practise. The rule is defended on the grounds that it ensures that independent barristers are available, even within the same

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<sup>22</sup> LECG report paras 442(i) and 205 - 210.

<sup>23</sup> A Regulation Review Working Party of the Law Society is considering proposals to reform the restriction on cold calling. See *Financial Times*, 2 January 2001, page 1.

<sup>24</sup> LECG report paras 442(i) and 209 - 210.

<sup>25</sup> See note 23.

<sup>26</sup> LECG report paras 442(ii) and 211 - 221.

<sup>27</sup> LECG report paras 444 and 280 - 291.

sets of chambers as the barrister appearing for the other side. However, it is open to question whether the restriction is necessary or proportionate to achieve this objective. The requirement that only sole practitioners can supply barristers' services is anomalous in the context of professional services and beyond. A similar requirement for, say, bookselling would have clear disadvantages in terms of, inter alia, costs, price, efficiency, innovation and choice. While bookselling and the supply of legal services by barristers have rather different economic characteristics, the same general economic principles should apply. Moreover, the sole practitioner requirement might also have the effect of deterring some people from a career as a barrister who would be at least as able professionally as those who become barristers, but who do not have the financial resources to fall back on if their flow of business were to fall off, or who are quite reasonably averse to such financial risk. Lifting of the restriction could therefore help broaden access to and diversity in the profession.

## Conduct

- Restrictions on barristers having direct access to clients.<sup>28</sup>

With certain exceptions specified in rules issued by the Bar Council,<sup>29</sup> barristers may be instructed to provide legal services only through solicitors rather than directly by individuals and firms. These rules restrict barristers' ability to compete with each other and with solicitors. There is no objection to a barrister choosing not to deal with clients without the intermediary of a solicitor. The objection is to the professional rule denying freedom of choice. And as noted earlier, restrictions on direct access to barristers sit particularly oddly with the QC system: well-informed purchasers should not need a quality mark to assist their choices.

- Restrictions on comparative fee advertising.<sup>30</sup>

Barristers are prohibited from making direct comparisons with other barristers and from referring to their success rates. These restrictions may restrict competition perhaps especially for individuals and smaller clients, and they may limit the ability of prospective clients to compare relative value for money.

- Right to conduct litigation:<sup>31</sup> extension of the Bar Council Code of Conduct.

The Bar Council is currently consulting upon a proposal to exercise the power (given to it under the Access to Justice Act 1999) to give rights to conduct litigation to employed barristers. It has chosen not to give independent barristers rights to conduct litigation. This prevents potential efficiencies and limits the number of lawyers who are able to conduct litigation on behalf of clients.

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<sup>28</sup> LECG report paras 445(i) and 262 - 265.

<sup>29</sup> Bar Council Code of Conduct 7th edition paras 401, 1001 and Annex F.

<sup>30</sup> LECG report para 445(ii) 292 - 294.

<sup>31</sup> LECG report paras 443(i) and 258 - 261.

## Accountancy

### Conduct

- Advertising<sup>32</sup> (*ICAEW Handbook 2000*; *ACCA Guidelines*; *AAT Guidelines*).

Accountants are prohibited from seeking the business of potential clients by telephone and from comparative fee advertising. There is evidence that this may restrict competition by smaller firms for the custom of smaller businesses and individuals or smaller clients.

- Restrictions on receiving a payment for referring clients<sup>33</sup> (*ICAEW Handbook*).

*ICAEW* members may not pay for business referred to them by third parties. This may be inhibiting the development of online accountancy market places. However, the *ICAEW* is believed to be considering relaxation of these rules. This is to be welcomed.

## Architecture

### Conduct

- Fee guidance<sup>34</sup> (*RIBA fee scales*).

*RIBA* issues non-mandatory guidance to architects on the amount to be charged for projects. The fee guidance curves are based on historical data that can be updated by a tender price index and by shifts in the price curves to reflect market conditions. This guidance could act to restrict or distort price competition. In particular, it may hinder the ability of efficient service providers to compete by reducing price to reflect their lower costs. At the same time, it may protect those who are less efficient and thus reduce the incentive they have to improve.

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<sup>32</sup> LECG report paras 448(i) and 351 - 358.

<sup>33</sup> LECG report paras 448(ii) and 351 - 358.

<sup>34</sup> LECG report paras 449 and 415 - 420.

## **XV FULLER IMPLEMENTATION OF EXISTING LEGISLATION**

### **Solicitors**

#### **Advocacy<sup>35</sup>**

- The Access to Justice Act 1999 provided for solicitors to have rights of audience in all courts, subject to training requirements laid down by the Law Society (the Higher Courts Qualification Regulations 2000). These regulations make it easier than in the past for solicitors to qualify as higher court advocates. However, evidence of increased numbers of solicitor advocates competing to provide advocacy services remains limited. This may be because of negative third party perception of solicitor advocates. The operation of the Higher Courts Qualification Regulations 2000 should be monitored to evaluate effectiveness. Further deregulation may be necessary to facilitate entry into advocacy by solicitors and other suitably qualified professionals.

#### **Conveyancing<sup>36</sup>**

- Fresh consideration should be given to implementing the parts of sections 34-52 of the Courts and Legal Services Act not so far implemented, with a view to increasing competition in the provision of conveyancing services. That Act provided for an exemption for authorised practitioners from the prohibition in the Solicitors Act on unqualified persons undertaking certain functions in relation to land transactions. There is currently little competition to solicitors in the provision of conveyancing services: solicitors have at least 95% of the market and licensed conveyancers have a very small market share. Implementation of the rest of sections 34-52 would allow, for example, banks and building societies to provide conveyancing services. This should increase competition in the market. That should also allow the efficient reallocation of the skills of some solicitors.

#### **Probate<sup>37</sup>**

- Fresh consideration should be given to the implementation of section 54 and 55 of the Courts and Legal Services Act to allow banks, building societies and insurance companies to provide probate services. Currently, such organisations may provide probate services when named as executors of a will, but they may not be instructed to act as agents of an executor. Implementation of sections 54 and 55 would be likely to increase competition in the market for probate services.

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<sup>35</sup> LECG report paras 440(i) and 171 - 177.

<sup>36</sup> LECG report paras 440(ii) 183 - 184.

<sup>37</sup> LECG report paras 440 (iii) and 185 - 186.

## XVI FURTHER WORK

### Insolvency practitioners

51. The review also touched on the rules and regulations applying to insolvency practice. LECG did not have time to investigate these fully, but noted that the rights of senior creditors to appoint receivers raised a fundamental issue of incentives. Senior creditors may be paid out in full, in which case the receivers' charges fall to be met out of the proceeds remaining for distribution to the junior creditors. In other words, the receivers are appointed by creditors who do not bear the consequences of excessive charges. This is not an issue which can be addressed using OFT powers, however; it is rather one for their regulators. In this regard, the increased emphasis on transparency in remuneration that has resulted from the *Ferris Report*,<sup>38</sup> published in July 1998, is to be welcomed.
52. LECG also noted concerns over a possible bottleneck due to restrictions on entry to the profession, which might restrict supply and push up charges. Stringent requirements for authorisation are designed to ensure that only individuals with a high degree of probity and professional competence are authorised. Justification for a high standard is said to stem from the complexity and variety of matters that a practitioner may be called upon to deal with. This raises the issue of whether a more limited authorisation should be made available which allows practitioners to undertake some of the more straightforward functions of an insolvency practitioner. This matter was considered by the Insolvency Regulation Working Party in its 1999 Report,<sup>39</sup> which concluded that, on balance, limited authorisation was not desirable but indicated that a different view might be taken if it were shown that the rigorous requirements for authorisation were creating a shortage of practitioners. Our consultation has not sought to resolve this point definitively. We would suggest, however, that the question is not whether or not there is a 'shortage', but whether the authorisation requirements go further than necessary to ensure competent supply of the services concerned.
53. The Insolvency Act, which received Royal Assent late last year, provides the Secretary of State for Trade and Industry with a power to recognise a body so that it may grant limited authorisation to individuals to undertake certain types of work relating to voluntary arrangements. When the relevant provisions come into force, this will provide a useful mechanism to address restrictions of competition that might arise in these areas.

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<sup>38</sup> Report of Mr Justice Ferris' Working Party on the Remuneration of Office Holders, July 1998.

<sup>39</sup> *A Review of Insolvency Practitioner Regulation*. Report by the Insolvency Regulation Working Party February 1999.

## XVII CONCLUSION

54. The approach in this review is based on principles that apply to the general span of economic activities. It is applicable in general to professions not covered in detail, or at all, in the review. It is our intention to apply the lessons of the review in our ongoing work across the whole range of the professions. It is also our intention that the lessons learned will inform work on the professions in Scotland and Northern Ireland.
55. Our approach recognises that in some areas the professions themselves have action in hand, or could take action, to remedy the restrictions found. It allows a period of not more than one year for this action to be progressed. This would avoid the need for intervention, provided real progress is made. We will take action after this grace period if necessary, or earlier if there is no evidence of a willingness to make changes.
56. The recommendation that competition law apply to the professions without potential exclusion is a specific expression of our more general view that the professions should be subject to competition law in the same way as other economic actors. If the application of competition to the professions is restricted, so too is the ability of the OFT to ensure that markets for professional services work well and that consumers benefit from this.

**Restrictions on Competition in the  
Provision of  
Professional Services**

**A Report for the Office of Fair Trading**

**By LECG Ltd.**

**December 2000**





## CONTENTS

<b>CONTENTS .....</b>	<b>1</b>
<b>I Introduction.....</b>	<b>3</b>
Our remit .....	3
General characteristics of the professions.....	3
Our methodology .....	5
Report structure.....	7
<b>II Restrictions and competition .....</b>	<b>8</b>
Possible imperfections in professional services markets .....	8
Regulation and the role of professional bodies.....	9
Market failure.....	10
Non-regulatory corrective mechanisms .....	12
Types of restriction and their prevalence world-wide .....	15
Justifications for restrictions on direct entry, indirect entry and conduct.....	20
Empirical evidence on the impact of restrictions on quality of service.....	21
Potential impacts on competition from restrictions in the provision of professional services.....	23
Empirical evidence on the competition impacts from restrictions on the provision of professional services .....	27
<b>III The role of competition Policy .....</b>	<b>29</b>
The Fair Trading Act 1973 .....	29
The Competition Act 1998.....	30
A framework for the economic analysis of restrictions .....	31
Stages 1 and 2: market failure and non-regulatory corrective mechanisms .....	32
Stages 3 and 4: regulation or no regulation .....	33
Who should do the regulating? .....	34
Alternative restrictions.....	34
General reforms .....	35
Direct entry .....	35
Demarcation.....	35
Conduct .....	36
Highlights in the history of reform of the professions.....	36
Other UK reforms .....	40
Reform of the professions in other countries .....	41
<b>IV Restrictions in the legal profession: solicitors .....</b>	<b>44</b>
Economic characteristics .....	44
Regulation of the solicitors' profession .....	50
Assessment of individual restrictions in the solicitors' profession.....	52
<b>V Restrictions in the legal profession: barristers.....</b>	<b>67</b>
Economic characteristics .....	67
Regulation of the barristers' profession.....	70
Assessment of individual restrictions in the barristers' profession .....	71
<b>VI Restrictions in the accountancy profession .....</b>	<b>84</b>
Economic characteristics .....	84
Regulation of the accountancy profession .....	90

---

Assessment of individual restrictions in the accountancy profession.....	91
<b>VII Restrictions in the architecture profession.....</b>	<b>101</b>
Economic characteristics .....	101
Regulation of the architecture profession .....	106
Assessment of individual restrictions in the architecture profession.....	108
<b>VIII Restrictions in the insolvency practitioners profession.....</b>	<b>117</b>
<b>IX Conclusions.....</b>	<b>119</b>
Law: solicitors.....	120
Law: barristers .....	121
Accountancy .....	122
Architecture.....	123
<b>Annex A List of Interviewees.....</b>	<b>124</b>
<b>Annex B Summary of MMC reports into professional restrictions.....</b>	<b>125</b>
<b>Annex C The ‘truncated rule of reason’ .....</b>	<b>132</b>
<b>Annex D Table of restrictions assessed .....</b>	<b>133</b>
<b>Annex E Excerpt of Kalisher report .....</b>	<b>137</b>
<b>Annex F List of restrictions not taken forward .....</b>	<b>138</b>
<b>Annex G References.....</b>	<b>139</b>

## I Introduction

### Our remit

1. On 27 July 2000, the Office of Fair Trading (OFT) commissioned LECG to carry out a study to identify restrictions, whether deriving from statute, professional rules or custom and practice, which have the effect of preventing, restricting or distorting competition in certain professions in England and Wales.<sup>1</sup>
2. This study took as its starting point the responses to the OFT consultation document, issued on 26 May, and on the basis of these responses the professions finally selected for detailed study were accountancy, architecture and law. Insofar as similar restrictions appear to be found in other professions, our study may serve as a starting point for investigating further.
3. At a later stage we considered whether insolvency could also be covered as a subset of accountancy and/or law, but we found it to be effectively a separate profession, with its own professional body and its own system of statutory and professional regulation (see Chapter VIII). Consequently, we were unable to investigate it in detail within this project.
4. Our remit was to assess the effect of the restrictions on competition, rather than to carry out a full public-interest assessment, which would require balancing competition detriments against other benefits. Thus, while we note in the report the benefits, which are claimed by those who defend the restrictions, we have not attempted to test the strength of these claims. We see the full public-interest assessment as a later stage in the process and we set out in Chapter III a suitable methodology for carrying it out.
5. We quickly discovered that there are many interactions between restrictions and, while in some cases their effect can be assessed individually, in others it is important to assess them as a group. For example, it is impossible to assess the effect of maintaining separate qualifications for solicitors and barristers without considering what categories of work are reserved to one or the other.

### General characteristics of the professions

6. There are certain common features of professions, which carry the risk of restriction or distortion of competition.<sup>2</sup> Each profession has one or more professional bodies, which regulate entry, for example by conducting examinations or by specifying a minimum period of experience before an individual is allowed to use the professional title in question.

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<sup>1</sup> Regulation of particular practices in the legal profession for the purposes of regulating that profession is a matter for the Scottish Executive. Partly for that reason and partly in the interests of focus, Scotland and Northern Ireland were excluded from our terms of reference.

<sup>2</sup> These issues are discussed more fully in Chapter II.

7. The claimed benefit of specifying professional qualifications and making the use of professional titles conditional thereon is that consumers will otherwise find it difficult to judge the quality of the advice they are purchasing. Most professional services are non-homogeneous<sup>3</sup> and the relationship between inputs and outputs is often unclear. A lawyer may provide excellent service and still lose the case, and vice versa. A professional qualification serves as a mark of at least a basic level of competence, and by implication quality of service, particularly when it is backed by the power to withdraw the professional title from those who act negligently or incompetently.<sup>4</sup>
8. The risk, however, in competition terms, is that a professional body has the power to set entry standards higher than potential users of the service would wish, assuming that they were perfectly informed. There is, at least in theory, an incentive to do so, because making entry to the profession more difficult can raise the average incomes of those who already belong to it. The losers in such circumstances are clients, who pay more than they need, and would-be professionals, who are excluded.
9. An extreme form of this would be a quota on new professionals qualifying each year. Even a simpler restriction, such as lengthening the qualifying period, could raise the incomes of existing professionals by raising rivals' costs. The effectiveness of such tactics can be enhanced by formally reserving certain services to members of the profession (a practice referred to here as demarcation). Even where non-members are allowed to perform given services, they may be less effective competitors because the existence of the qualification creates perceptions among clients that those who do not have it provide inferior quality.
10. Guidance on what constitutes a reasonable fee is justified by some professionals as protecting clients by reducing informational asymmetries between them and their advisers. However, fee guidance can exacerbate the adverse effect of entry restrictions by reducing price competition between those players who are "qualified".
11. Self-regulating professions may have incentives to restrict competition in other ways. For example, one motive for controls on business organisation (such as a prohibition on outside shareholding or on multi-disciplinary partnerships) could be to raise the cost of providing the services. Paradoxically, this can raise the profits of the firms involved (as explained in paragraphs 73 to 77). Controls on the way in which professionals market themselves could have a similar effect. Conversely, it is also argued that these rules have other motivations, such as a desire to preserve the independence of advice or to maintain public confidence in its quality. It is worth noting that not all regulation is imposed by the profession

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<sup>3</sup> With the exception of some services to individuals like conveyancing of a house.

<sup>4</sup> In more technical language, the qualification requirements reduce the informational asymmetry between professional and client.

itself: governments too (at both national and EU level) have thought it desirable to impose certain controls by statute.<sup>5</sup>

12. Thus, professions have characteristics, which require and justify a degree of regulation, but the existence of regulation, particularly self-regulation, carries with it the risk of an adverse effect on competition. The interests of clients, and of the economy as a whole, will best be served by striking a balance between benefits and detriments in the light of the facts in each case.
13. In our view, this balance is best struck by the competition authorities, since they have considerable experience of so doing in other sectors of the economy. Under the Competition Act (CA) 1998, the OFT (and the Competition Commission - CC - as an appeal body) has to consider whether agreements which appreciably restrict competition might nevertheless be justified on grounds of improved production, distribution or economic progress. Under the Fair Trading Act 1973, the CC is required to balance competition and all other relevant factors to arrive at a judgement on where the public interest lies. We do not believe that the exercise of striking a balance is significantly different in the professions from that in other sectors.

### **Our methodology**

14. To inform our analysis of specific restrictions in the professions under review, we have gathered quantitative data on fees, profits, numbers of professionals, number of firms, market shares, and so on. We found that comprehensive data are not available, particularly on architects and accountants.
15. We have also reviewed a substantial amount of overseas experience: restrictions in other countries, economic theory and empirical studies. This has helped us to form conclusions on restrictions in England and Wales.
16. In parallel, we analysed the responses to the OFT's consultation exercise and drew up a list of restrictions about which representations had been made. We are grateful for the assistance of OFT staff in this process. From this list, we eliminated certain restrictions which either seemed not to raise competition issues, or where we believed the effect would be insignificant.
17. This left us with a short list of restrictions for study. In each case, we identified the origin of the restriction in European law, UK statute, professional rules, custom and practice or simply market perceptions. A summary of the restrictions and their origins is given at Annex D. We also identified interactions between restrictions.

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<sup>5</sup> For example, the validation process for courses leading to qualification as an architect in the UK is laid down in an EU Directive.

18. We then investigated the effect of each restriction on competition. This was largely done through an interview programme, supplemented by further data analysis. We interviewed a broad range of professional bodies, professional firms (including small firms and new entrants) and government departments. A full list is at Annex A.
19. It was notable that few users of professional services, or bodies representing them, replied to the OFT consultation. We thought it was important to give users further opportunities to comment and sent a copy of the original OFT consultation document to the Company Secretaries or Finance Directors of the 50 largest companies in the UK. We also interviewed the CBI and the One Hundred Group (whose members are the Finance Directors of the FTSE 100 companies). To research the views of personal clients, we interviewed the Consumers Association and reviewed market research on users of legal services.
20. These investigations did not uncover significant concerns among users of professional services, whether about quality, price or innovation. There are two possible explanations. One is that the professions are providing a high standard of service at a reasonable price. The other is that they may not be, but that clients have difficulty in judging whether they have received good service and what would constitute a reasonable price. It is more difficult for customers to judge these matters in professional services than in the case of homogeneous products, so the lack of concern amongst users is ambiguous.
21. Having completed our fact-finding, we proceeded to form provisional conclusions as to whether each restriction had an adverse effect on competition. The standard we have applied is that, to find an adverse effect, there must be some evidence that the restriction (by itself or in combination with other restrictions) is significantly reducing the number of competing players in a market, or their freedom to compete with one another, or their freedom to innovate and compete in new ways in future. We have not included rules or statutes which, in theory and under certain conditions, *might* restrict competition. We make no presumption that all rules and statutes affecting the professions are restrictive of competition.
22. On the other hand, we have not demanded concrete evidence of higher prices or lower quality before concluding that there is a restriction of competition. By and large, insufficient detailed quantitative data is available to do this, but we believe that the standard we have applied is similar to that used in many CC (or MMC) reports. There is, we acknowledge, some element of judgement in our conclusions.
23. The evidence we rely on comes in some cases from those operating in the market place or their representatives (for example, some professional firms gave us evidence about the effect of restrictions imposed by other professions). In some cases, the evidence is from overseas experience. Generally we have not classed a

rule as restrictive unless there is reason to believe that, if it were removed, new competition would result.

24. When we had formed our provisional conclusions, we sent them for comment to those professional bodies whom we had interviewed. Because of time constraints, we were only able to allow these bodies a week to comment, but we received a number of suggestions about other issues that needed to be taken into account. Where these relate to countervailing benefits, they are not a matter for this report. Where they relate to competition effects, we have taken account of them in the text.

### **Report structure**

25. The remainder of this report is structured as follows:
- Chapter II: Restrictions and competition
  - Chapter III: The role of competition Policy
  - Chapter IV: Restrictions in the legal profession: solicitors
  - Chapter V: Restrictions in the legal profession: barristers
  - Chapter VI: Restrictions in the accountancy profession
  - Chapter VII: Restrictions in the architecture profession
  - Chapter VIII: Restrictions in the insolvency practitioners profession
  - Chapter IX: Conclusions



## **II Restrictions and competition**

### **Possible imperfections in professional services markets**

26. Professional services markets are often highly imperfect. An asymmetry of information between buyers and sellers concerning the characteristics (or “quality”) of the service in question can be an important cause of market failure. Markets may also fail, however, as a result of externalities (impacts on third parties not directly involved in a professional service transaction), the abuse of market power or combinations of all three sources. In the absence of corrective mechanisms (such as a strong role for reputation or some form of regulation), they may fail altogether.
27. Each type of market failure can lead to consumer detriment (a loss of consumer welfare relative to a competitive and fully functioning market). For example, asymmetric information could lead to consumers not purchasing a service that they would have purchased had they possessed full knowledge of the service’s characteristics. Alternatively, they might have paid over the odds for a suitable service when a cheaper provider existed. Consumers might also have bought an unsuitable service or a low quality service that they believed was of high quality.
28. The risk of market failure is usually cited as the justification for regulation of professional service markets – often through the imposition of restrictions on entry to a profession, or restrictions on the structure and conduct of service providers by a professional body. Liberalisation of such restrictions must be preceded, therefore, by a careful consideration of the type and extent of market failure for each individual professional service on offer. Potential reformers must also assess the significance of non-regulatory mechanisms – such as litigation or the third-party provision of consumer information – that may help correct market failures and render regulation redundant. Only then should the costs and benefits of alternative forms of regulation (including no regulation at all) be considered. Related to this last issue is the role of self-regulation through professional bodies and the possibility that professional services providers will use regulation ostensibly to correct information or externality-driven market failure, but in practice to enhance market power.
29. In this chapter we consider the theory and empirical evidence related to restrictions imposed on the professions. In particular, we discuss:
  - Regulatory mechanisms and the role of professional bodies;
  - Market failure;
  - Non-regulatory corrective mechanisms;
  - Types of restrictions and their prevalence in the legal, accountancy and architecture professions world-wide;
  - Justifications for restrictions;
  - Empirical evidence in relation to these justifications;

- Alternative theories that have been applied to different types of restriction to explain the potential impacts on competition; and finally,
- Empirical evidence on the impacts of restrictions on competition.

### **Regulation and the role of professional bodies**

30. For historical and practical reasons self-regulation via a professional body (but sometimes reinforced by legal statute) has played a central role in the professions. Shapland & Sorsby<sup>6</sup> define a professional body along the following lines “*By a professional body we mean, in general, those which have educational or experience entry barriers to qualify its members, which keep a register of their members, which provide a code of conduct or guidance for their members’ professional work and which have a complaints/disciplinary function*”. In the UK, most professional bodies are incorporated as limited companies under the Companies Acts or as chartered bodies through the grant of a royal charter. Professional bodies usually have a dual function: as regulators and as representatives of their profession. In the UK, for example, the Institute of Chartered Accountants in England and Wales (ICAEW) has a disciplinary panel and also lobbies government on issues such as limited liability partnerships.
31. In this section we discuss, albeit only in general terms, the regulatory functions of professional bodies and their incentives for seeking to impose restrictions on entry and conduct. Later in this chapter we examine in detail the types of regulatory restriction imposed by professional bodies, how they might address the market failures discussed below, and how they might also serve to limit competition. Chapter III discusses the role of competition policy as a driver of reform, whilst Chapters IV, V, VI, VII, and VIII consider the particular arrangements currently in place in the UK professions under review.
32. Consumers and professionals alike have incentives to impose restrictions on professionals. Consumers want to be able, on the basis of sound knowledge, to choose a combination of price and quality that best suits their needs (i.e. they need to overcome the market failures and the shortcomings of the non-regulatory mechanisms discussed in the next section). Individual consumers, however, are unlikely to be able to determine the optimal package of restrictions, which will achieve these ends, thanks to a combination of cost, difficulty of co-ordination across scattered individuals, and the free-rider problem (“let others do the lobbying”).
33. Professional service practitioners are likely to have incentives to impose restrictions on themselves, which are no less strong but more easily effected, since an apparent concern for the public interest may disguise an opportunity to increase incomes by limiting competition. Adam Smith’s famous quotation<sup>7</sup>

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<sup>6</sup> Shapland & Sorsby: *Professional Bodies’ Communications with Members and Clients*, OFT 1996 paragraph 1.3.4.

<sup>7</sup> Adam Smith, *An inquiry into the nature and causes of the wealth of nations*, 1776.

encapsulates this idea: “*people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices...Though the law cannot hinder people of the same trade from sometimes meeting together, it ought to do nothing to facilitate such assemblies, much less to render them necessary*”. A more recent opinion from the US Supreme Court<sup>8</sup> expresses the same sentiments in relation to the anti-competitive potential of professional associations: “*Non profit entities organised on behalf of for-profit members have the same capacity and derivatively, at least, the same incentives as for-profit organisations to engage in unfair methods of competition*” (California Dental Association v FTC, 1999). Moreover, once practitioners become members of a professional body, there are likely to be incentives for them to discipline violations of those restrictions that inhibit competition in order to protect existing incomes.

34. Self-regulation via professional bodies is the likely outcome of incentives towards the regulation of professional services. The likelihood of such an outcome is reinforced, however, by the fact that professionals themselves are often in the best position to judge the level of restrictions necessary to preserve quality standards, for example the qualifications necessary to enter the profession. As a result, restrictions on a profession often originate from the professional body, are usually justified in terms that suggest they address market failure (or preserve quality standards), but may in fact be acting so as to inhibit competition.

### **Market failure**

#### **Search goods, experience goods and credence goods**

35. Many of the goods we purchase, such as an article of clothing or a pencil, are “search goods”. Their quality can (by and large) be ascertained prior to purchase and so the main issues for consumers are product selection and price. For two other types of goods (or service) an additional issue arises: information. “Experience goods” have characteristics that are learned by consumers only after they have made the purchase. Examples include the quality of a restaurant meal or the soup in a tin. In these examples, consumers discover the characteristics of their purchases immediately or soon after consumption. Annual car services, on the other hand, are a “credence good”. Such goods and services suffer from an extreme form of information asymmetry in that their quality usually only becomes apparent some time after purchase, if ever.
36. Some professional services can be classed as “experience” goods. For example, the purchase of a pair of spectacles to meet a particular eye prescription or a tax return service where there are routine checks by the Inland Revenue. In both cases, consumers would find out immediately or quite quickly whether they had made appropriate purchases. Many professional services, however, are best characterised as “credence” goods. Firstly, consumers may not be adequately

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<sup>8</sup> 119 S.Ct. at 1611-12 cited in Calkins: *California Dental Association: not a quick look but not the full monty*, Antitrust Law Journal, 2000.

able to gauge the quality of the service they have bought because a degree of technical complexity and/or a significant degree of judgement is involved, possibly beyond the buyer's experience. Secondly, there may be an ambiguous relationship between the quality of the service provided and the outcome. For example, a lawyer may lose a case despite his or her best efforts, or may win as the result of entirely fortuitous circumstances. In neither case can the consumer discern the true role of the professional advice purchased.

### Consequences of information asymmetry

37. The disparity between the information held by the service provider and that held by the consumer could lead to market failure where the former has strong incentives to cut quality (it is costly to provide) without a corresponding reduction in price. Consumers are unable to observe whether individual firms have behaved in this way and have therefore to base their purchasing decisions on the average expected quality for the average price charged in the market. If many service providers are tempted to degrade quality in this way, the average quality of services in the market will fall. Economic theory suggests that fewer consumers will then purchase services and that, in the extreme, those firms still providing high quality services may go out of business. Conversely, and perversely, a high-quality firm that cuts its prices in order to compete with lower-quality rivals may only hasten its own demise if consumers interpret such action as evidence of poor quality. In the absence of reliable information on a service provider, consumers will often rely on "signals", that is to say incomplete or possibly inconclusive indications. Thus there could be market failure which leads to an inadequate supply of quality services or, in the extreme, no services are provided at all.
38. Empirical evidence confirms that such market failures do exist in the provision of professional services. A survey by the Financial Services Authority<sup>9</sup> found that information-related reasons were second only to "lack of money" as a "reason for not buying a [financial] product" and as "barriers to buying financial products for inactive consumers". This evidence of a degree of market failure is despite the fact that the on-going performance of many financial products can be measured after purchase (i.e. they are often experience goods), and the existence of regulation in financial markets designed to overcome problems such as asymmetric information. We think it likely that the difficulties which consumers face because of information asymmetry will be more severe in relation to complex professional services (many of which are credence goods rather than experience goods).

### Market power and externalities

39. Although information-related problems are the most commonly cited source of market failure in the professions, two additional causes are market power and the existence of externalities. The word "externality" is an economic term which in

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<sup>9</sup> FSA: *Better informed consumers report*, April 2000, cited in a report for the FSA by London Economics: *Polarisation and Financial Services Intermediary Regulation* (July 2000), pp 27-28.

this context refers to the impacts (beneficial or adverse) on third parties arising from decisions made by professionals and their clients. For example, a firm's trade creditors and lenders may make important decisions based on an auditor's report. The firm itself, however, may have chosen<sup>10</sup> the auditor purely on price rather than on relevant experience or "quality" in order to reduce costs and increase its "private" benefit. In this way, any adverse impact on trade creditors and lenders is external to the firm's own decision – hence the term "externality". Similarly, an architect's poor design for a hospital or skyscraper can have obvious and wide-ranging implications for third parties. In practice, of course, there are counter-mechanisms (such as reputation effects and liability for negligence) which help to deter such short-sighted behaviour. These are discussed in the next section. With respect to market power, ineffective competition may permit monopoly pricing and reduce the incentive on service providers to maintain efficient operating practices and to innovate. The impact on consumers will be felt as some combination of high prices, lower quality advice, and lack of choice in terms of services on offer. The potential contribution of existing regulation / restrictions to this type of market failure is the subject of this report.

### **Non-regulatory corrective mechanisms**

40. The presence of market failure, of which three different types are described in the section above, is a necessary but insufficient condition for the imposition of regulation. A range of non-regulatory mechanisms may exist which partially or completely correct for market failure. The role of warranties, litigation, informed consumers, repeat purchases and reputation are all relevant, and are discussed below.

### **Warranties**

41. Perhaps the most obvious non-regulatory mechanism is the use of warranties – guaranteeing the consumer a specified service quality in advance of purchase and possibly thereby signalling the high quality of services to potential clients. This device often fails to combat market failure, however, as a consequence of the same information-related reasons that create the market failure itself (and so their use is rare within the professions). As described earlier, the "performance" of professional advice depends on a variety of factors in addition to its quality. One such factor is the way in which the client uses the advice. Bankruptcy, for example, may result from poor accounting advice or from the behaviour of the firm employing the accountant. Consequently, a client's incentive to use advice sensibly will be reduced if the warranty provides full compensation in the event of failure. Perversely, warranties offered by professional services firms may even act as a magnet to higher risk or downright reckless clients. Information asymmetry (this time in favour of the client) will, therefore, restrict the use of warranties to those professional services with a strong link to the eventual outcome regardless

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<sup>10</sup> We are aware, of course, that in the case of a limited liability company the auditors are, technically, appointed by and answerable to the shareholders. Our use of the word "firm" here thus encompasses shareholders as well as its directors.

of how the advice is “consumed”. In such cases the use of conditional fees (for instance, where the amount of the fee is in some way related to the outcome) is one way of providing a degree of quality assurance.

### **Litigation**

42. Professional negligence or incompetence leading to harm can lead to litigation. The threat of action by the courts to compensate a client receiving poor quality advice should in theory provide an incentive on professional services providers to maintain quality standards and thus overcome a potential market failure. Litigation plays a role for some professional services – as a discipline for auditors, for example - and most professionals hold indemnity insurance in case they are successfully sued. However, as with warranties, the role of litigation is constrained by informational problems. The courts characteristically face substantial difficulty and costs in determining the quality of the service at issue and in linking that service to the eventual outcome and detriment to the client. As a result, litigation is likely to compensate for market failure only for services where the outcome is measurable and easily linked to the input, and where the client is large enough to bear the associated measurement costs.

### **Consumer Reports**

43. In some cases, a sufficient proportion of well-informed (and demanding) consumers can ensure that quality is maintained for all potential clients. Consumer Reports providing information on the quality of services of particular providers is one route through which consumers can become well informed. This mechanism will not apply in the case of most professional services, however, because of the ability of providers to vary the quality of their services. Even if secret monitoring were feasible, there would still be the problem of measuring the quality of advice, which itself involves a high degree of professional judgement.
44. Moreover, there is even a potential market failure problem facing a consumer’s decision to become better informed. For example, subscription to a Consumer Report is a decision which will be based on a consideration of the consumer’s private costs and benefits – not on the positive externalities bestowed on those who remain uninformed (although this could be tackled via government intervention, such as a subsidy to producing Consumer Reports). Other consumers, aware of the spillover benefits from others’ subscribing, may choose to ‘free ride.’ Accordingly, there may be too few well-informed consumers to counter-act either the original or subsequent market failure.

### **Repeat purchases and reputation**

45. For experience goods (and therefore for certain professional services) an important non-regulatory mechanism for maintaining quality standards is the possibility of repeat purchases. The maker of a good wine vintage, for example, will benefit directly from repeat purchases of that particular vintage. For many professional and other services, however, quality is endogenous, i.e. cannot be judged externally before consumers decide to buy. In other words, the provider is

free to vary quality over time. The example of restaurant meals may again be helpful: eating a first good meal in a restaurant does not guarantee a meal of comparable quality for a repeat purchase. As a result, if there are any incentives to maintain quality from repeat purchases they are indirect and relate to the concept of reputation. If some consumers can evaluate quality and can make that evaluation known more widely, reputations will be formed for individual service providers that serve to signal that quality to others.

46. Under certain conditions this reputation mechanism can mitigate a potential market failure. According to the Kreps-Wilson / Milgrom-Roberts model of asymmetric information<sup>11</sup> the necessary conditions required are three-fold: (a) at least a small probability in the view of consumers that the professional will choose to provide a high quality service in order to induce repeat purchases, (b) the quality of the service is learnt quickly by sufficient numbers of consumers, and (c) repeat purchases are frequent enough to provide a return on the professional's initial honesty in providing a high quality service. This model suggests that the significance of reputation effects will vary according to both the type of service and the type of client. A routine service bought regularly by a large client is the most likely to benefit from reputation effects: quality is measurable, the client has the resources to measure it, and the provider can benefit from the client acting on this knowledge in making repeat purchases.
47. Complex services (where quality provision is endogenous), services purchased by small clients and services bought infrequently are less likely to benefit from reputation and are more likely to suffer from market failure as a result. (Unless, for example, the firm that provides these services also provides services where reputation plays a key role and, furthermore, any attempt to compromise on quality for some types of services / clients would damage its wider reputation). Empirical evidence on the purchasing behaviour of consumers can throw some light on the extent of repeat purchasing and the role of reputation. Recent research commissioned by the Law Society<sup>12</sup> into the level of satisfaction with solicitors' services amongst private (i.e. non-corporate) clients examined the most important factors determining choice of solicitor or solicitors' firm. Just under a third (31%) of clients said that the firm had been recommended to them, almost a fifth (18%) stated that they had used the firm before, and 12% had chosen the firm primarily on the grounds of reputation. On the face of it, therefore, reputation type factors do appear to play a role in professional services markets – even for small, non-corporate clients. However, it is not clear from these results to what extent this buying behaviour translates into quality incentives.

### **Shortcomings of non-regulatory mechanisms**

48. We conclude that, in the absence of regulation, there are a range of different non-regulatory mechanisms available that may serve to correct market failure in the provision of professional services. We also conclude, however, that these

<sup>11</sup> See Chapter 2 of Tirole: *The Theory of Industrial Organisation*, MIT 1988.

<sup>12</sup> Law Society 2000 Survey of Solicitors' Clients, The Law Society.

mechanisms will not operate satisfactorily for a substantial number of professional services (particularly for complex services purchased on an *ad hoc* basis) and for certain types of consumer (particularly ill informed consumers without the resources to monitor quality provision). It follows that there is likely to be some role for regulation in certain professional service markets.

49. Empirical evidence from other countries on the impacts of particular types of professional restrictions on competition and quality are presented in the remainder of this chapter. However, as we make clear in Chapter III, only by examining each restriction in turn (and in combination) will policy-makers be able to discern the actual net effect on the public interest. In Chapter III we also summarise the long history of reforms to the professions in the UK as a result of the application of this type of approach.

### **Types of restriction and their prevalence world-wide**

50. The origins of the restrictions imposed on the structure and behaviour of the professions in the UK are extremely diverse, ranging from statute to codes of conduct to custom and practice - or some combination of all three. A second feature of the restrictions imposed is their inter-dependence. A whole group of self-imposed restrictions may, for example, be reliant on a single key restriction whose origin is statutory. Nevertheless, it is possible to impose some order on this diverse and inter-related network of restrictions. Most restrictions can be placed in one of three broad categories according to their function<sup>13</sup>:
- Direct entry restrictions;
  - Indirect entry restrictions; and,
  - Conduct restrictions.
51. Under these three headings, we list the different types of restrictions that are imposed on professionals and their prevalence internationally. A detailed description of each of the restrictions imposed on the professions under review is left until later chapters.

### **Direct entry restrictions**

52. Direct entry restrictions embrace the educational and experience qualifications required for membership of a professional body or for certification to practice. They are justified in terms of an *ex ante* quality control, but may act simply to deter entry to a profession (later sections examine each of these interpretations in detail). This category of restrictions also includes post-qualification educational or experience requirements (for example, Continuing Professional Development (CPD) requirements); the definition and protection of professional titles (e.g. limiting the use of a certain title to members of recognised professional bodies); and requirements to hold personal indemnity insurance.

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<sup>13</sup> There are alternative classifications: distinguishing between “structural” and “conduct” restrictions, for example.



53. Table 1<sup>14</sup> contains an international comparison of the qualification requirements for the professions under review. The UK was broadly in line with other countries in this snapshot of direct entry restrictions from the mid-1990s. Chapter III takes a more dynamic perspective which outlines the on-going reform of restrictions imposed on professional bodies in this country and elsewhere in the world.

**Table 1: A comparison of direct entry restrictions**

<b>Lawyers</b>	<b>UK</b>	<b>International Average</b>
Higher education required	4 to 5 years	4.7 years
Experience required	1 to 2 years	2.6 years
Professional examination	12 required / 7 not required	
Mandatory membership of professional body	17 required (including UK) / 4 not required	
<b>Accountants</b>	<b>UK</b>	<b>International Average</b>
Higher education required	Not required <sup>15</sup>	4.1 years
Experience required	3 years	3.3 years
Professional examination	19 required (including UK) / 1 not required	
Mandatory membership of professional body	9 required (including UK for auditors, certified and chartered accountants) / 10 not required	
<b>Architects</b>	<b>UK</b>	<b>International Average</b>
Higher education required	5 years	4.8 years
Experience required	2 years	2.1 years
Professional examination	6 required / 15 not required (including UK)	
Mandatory membership of professional body	10 required / 11 not required (including UK)	

Sources: see footnote 14

### **Indirect entry restrictions**

54. Indirect entry restrictions include the demarcation of services (the definition of specific types of work that a regulated professional can do) and constraints on the ownership, management and control of professional firms (for example, rules preventing fee sharing with other professionals). The former may facilitate specialisation or, by restricting supply to certified practitioners, reduce the danger

<sup>14</sup> Derived from Tables 2 and 3 in OECD Roundtable report, Chapter 3: *Regulatory Reform and Professional Business Services*. Original source: *International Trade in Professional Services, Assessing Barriers and Encouraging Reform*, OECD 1996. Countries included in the survey: Australia, Austria, Belgium, Canada, Czech Rep., Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, UK, USA.

<sup>15</sup> Some firms impose a degree-level requirement but no such requirement from professional bodies.

of significant negative externalities arising from low quality service provision. Demarcation may also inhibit competition between professions or between practitioners within a profession. Restrictions on business structure may help to preserve independence and prevent conflicts of interest. However, such restrictions may also constrain new entry to the profession and hinder innovation in service provision.

55. Table 2<sup>16</sup> sets out an international comparison of certain forms of indirect entry restriction for lawyers, accountants and architects. Demarcation restrictions are particularly marked in the case of legal representation in courts and for statutory audits. Other professional services are generally subject to lesser demarcation restrictions. Of the three professions, architects face the least stringent restrictions on indirect entry.

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<sup>16</sup> Derived from Tables 1 and 4 in OECD Roundtable report, Chapter 3: *Regulatory Reform and Professional Business Services*. Original source: *International Trade in Professional Services, Assessing Barriers and Encouraging Reform*, OECD 1996.

**Table 2: A comparison of indirect entry restrictions**

<b>Lawyers</b>	<b>Reserved</b>	<b>Shared between professions</b>	<b>No demarcation</b>
Representation in court	18 countries (but in 9 – incl. UK –shared between practitioners within a profession)	1 country	2 countries
Legal advice	9 countries (but in 4 shared between practitioners)	4 countries	8 countries (incl. UK) <sup>17</sup>
Conveyancing	14 countries (but in 4 shared between practitioners)	5 countries (incl. UK)	2 countries
Incorporation	4 unrestricted (incl. UK) / 6 partially restricted / 9 restricted		
<b>Accountants</b>	<b>Reserved</b>	<b>Shared between professions</b>	<b>No demarcation</b>
Statutory audit	20 countries (incl. UK) (but in 9 shared between practitioners)	4 countries	0 countries
Public sector audit	10 countries (but in 2 – incl. UK - shared between practitioners)	6 countries	5 countries
Accounting	5 countries (but in 1 shared between practitioners)	2 countries	16 countries (incl. UK)
Insolvency Practice	3 countries (incl. UK)	8 countries	9 countries
Incorporation	8 unrestricted (including UK) / 14 partially restricted / 3 restricted		
MDPs	2 unrestricted / 2 subject to permission / 10 restricted		
<b>Architects</b>	<b>Reserved</b>	<b>Shared between professions</b>	<b>No demarcation</b>
Construction permit	7 countries (but in 5 shared between practitioners)	3 countries	11 countries (incl. UK)
Monitoring	5 countries	5 countries	11 countries (incl. UK)
Technical control / certification	4 countries	5 countries (incl. UK)	10 countries
Incorporation	17 unrestricted (incl. UK) / 5 partially restricted / 3 restricted		

Sources: see footnote 16

<sup>17</sup> There are no general restrictions but certain specific areas remain demarcated.

### Conduct restrictions

56. The most prevalent restrictions under the third category, conduct restrictions, relate to ethical standards or codes of conduct (e.g. setting out obligations in relation to loyalty, competence, confidentiality and conflicts of interest); technical or performance standards (usually supported by disciplinary procedures); fee setting; and restrictions on advertising / marketing. As we discuss in later sections, restrictions on fee setting and advertising are the least defensible due to the absence of a clear link with service quality. Consequently, these types of conduct restriction have been subject to the greatest weight of reform internationally. Restrictions on fee setting typically involve mandatory or “recommended” fee scales for the use of professionals when charging for particular services. Advertising – particularly of fees or comparisons across firms - has until recently been significantly constrained.
57. Table 3<sup>18</sup> presents an international comparison of the restrictions in place on fee setting and advertising and shows that conduct restrictions were still very important at the time of the survey. Mandatory minimum or maximum fee levels were still imposed on at least some legal services in half the countries surveyed. For accountants in 14 of the 23 countries surveyed, advertising and/or marketing for at least some services was prohibited. As for the other types of restriction, architecture appears to have been subject to the least number of restrictions by far.

**Table 3: A comparison of conduct restrictions**

<b>Lawyers</b>	<b>Restricted</b>	<b>No restrictions</b>
Mandatory fee setting	10 countries	10 countries (incl. UK*)
Marketing/advertising	15 countries (incl. UK)	5 countries
<b>Accountants</b>	<b>Restricted</b>	<b>No restrictions</b>
Mandatory fee setting	9 countries	13 countries (incl. UK)
Marketing/advertising	14 countries (incl. UK)	9 countries
<b>Architects</b>	<b>Restricted</b>	<b>No restrictions</b>
Mandatory fee setting	6 countries	14 countries (incl. UK*)
Marketing/advertising	4 countries	15 countries (incl. UK)

\*But non-mandatory fee “guidelines” exist

Sources: see footnote 18

<sup>18</sup> Derived from Table 4 in OECD Roundtable report, Chapter 3: *Regulatory Reform and Professional Business Services*. Original source: *International Trade in Professional Services, Assessing Barriers and Encouraging Reform*, OECD 1996.

**Justifications for restrictions on direct entry, indirect entry and conduct**

58. Earlier in this chapter we outlined the types of market failure that can arise in the provision of professional services. Accordingly, the restrictions imposed on professions are usually justified on the grounds that they are mechanisms which aim to address market failure (although the justifications are usually couched in very much simpler terms: for example, as the means of ensuring the protection of high quality of services).
59. Where restrictions clearly do contribute to correcting market failure it is pertinent to ask whether they do so in the least damaging way for competition (and other public interest objectives). Fee scales are sometimes justified as satisfying a demand from consumers for guidance to help with their budget plans. There are, however, a variety of methods of addressing this demand, which have less potential impact on competition, such as historic surveys of actual fees charged or widespread advertising of fees coupled with active “shopping around” by consumers. Another example is restriction on permitted business structures, which is alleged to be justified as a means of avoiding conflicts of interest. In this case full mandatory disclosure of any such conflicts is one possible response that would have a lesser impact on competition.
60. Issues of this type can only be addressed satisfactorily on a case-by-case basis which assesses a full range of public interest trade-offs. We do not pursue such an approach here, although Chapter III provides a suggested framework for further analysis. In this section we present some arguments as to why restrictions may not address a market failure or quality concerns; or if they do, why they may not always be in the best interests of the public. We then turn to some recent empirical evidence which tests the linkages between restrictions and service quality.

**Why restrictions may not address problems of market failure**

61. The single most important challenge to the quality justification for restrictions relates to a difference in view over what is best for consumers. If a set of restrictions prevents access to all but the highest quality professional service providers, it has been argued that this may lead to an *overall* drop in quality. For example, if over-restrictive entry requirements, strict demarcation of services, or a prohibition on advertising lead to a prevalence of high prices, low-income consumers (or indeed companies seeking to control their costs) will not seek professional advice or will adopt “do-it-yourself” techniques. It is contended that consumer welfare will be maximised where there is a range of price/quality combinations on offer and each consumer is free to select the option that best suits his or her needs and means. In modern parlance, this may imply a range running from a high cost, top quality service to a budget “no frills” service. Consumers are, after all, usually in the best position to judge what is best for them since it is they who have to bear the consequences of making a poor choice.

62. There are other arguments which challenge the quality justification for particular types of restriction. For example, it is hard to assert that qualifications and experience restrictions on direct entry in particular) invariably improve or sustain quality of service provision because the link between the qualification/experience “input” and the service “output” is often, at best, tenuous. Quality of service is normally determined not by qualifications and experience alone but by additional factors such as, for instance, the amount of time that a practitioner chooses to spend with a client.
63. Some defenders of advertising restrictions argue that, because of asymmetric information and endogenous quality (see earlier in this chapter), price advertising may contribute to market failure. Price advertising increases demand for services from advertising firms - and they meet this extra demand by lowering quality, particularly since quality is unobservable. It follows, they say, that non-advertisers must either lose business or also engage in advertising and quality reduction. A succinct rebuttal of this argument came from the Supreme Court (*Bates v. State Bar of Arizona*, 1977): “*an attorney who is inclined to cut quality will do so regardless of the rule on advertising*”. Opponents of advertising restrictions point to possible quality improvements (at least for routine services where the risk of market failure is less severe) because high volumes encourage specialisation and innovation.
64. Although there are strengths and weaknesses in both lines of argument, for the majority of restrictions economic theory cannot be relied on to predict the net impact on quality of service. Consequently, we now look at empirical evidence.

#### **Empirical evidence on the impact of restrictions on quality of service**

65. Table 4 summarises the results of 15 comparative studies into quality effects arising from the liberalisation of restrictions on professional service provision. Most of these studies have been conducted in federal countries (predominantly in the USA) where basic economic conditions are substantially common across the states but where professional restrictions vary. Restrictions acting directly on dependent variables (such as quality of services or price) can be relatively easily isolated.

**Table 4: Summary of empirical studies into the impact of restrictions on quality of professional services**

Author	Date	Country	Profession	Restriction	Impact on quality
Holen(i)	1978	USA	Dentistry	Direct entry	Positive
Feldman & Begun(i)	1985		Optometry	Commercial practice, advertising, CPD	Positive
Healey(i)	1973	USA	Laboratory Personnel	Licensing	Neutral
Cady(ii)	1976	USA	Pharmacy	Advertising	Neutral
Muris(iii) & McChesney	1978	USA	Law	Advertising	Neutral
Bond et al. (iv)	1980	USA	Optometry	Advertising, commercial practice	Neutral
FTC(ii)	1983	USA	4 including pharmacy and optometry	Advertising	Neutral
Paul(i)	1984		Physicians	Licensing	Neutral
Young(i)	1986	USA	Accountancy	Licensing	Neutral
Trebilcock et al.(v)	1979	Canada	4 including law	Price advertising	Negative
Muris (vi) & McChesney	1979	USA	Law	Advertising	Negative
Carroll & Gaston(i)	1981	USA	7	Direct entry	Negative
Kwoka(vii)	1984	USA	Optometry	Advertising	Negative
Cebula (viii)	1998	USA	Law	Advertising	Negative
Martin(i)	1982	USA	Pharmacy	Direct entry	Mixed

Sources: see footnote 19

66. Table 4<sup>19</sup> shows that only two studies support the higher quality justification for restrictions (in one case from direct entry restrictions for dentists and in the other

<sup>19</sup>Sources:

(i) Results summarised in Cox & Foster: The Costs and Benefits of Occupational Regulation, FTC 1990.

(ii) Results summarised in Jacobs et al: Improving Consumer Access to Legal Services – the case for removing restrictions on truthful advertising, Cleveland Regional Office, FTC 1984.

(iii) Muris & McChesney: Advertising, consumer welfare and the quality of legal services, 1978.

(iv) Bond, Kwoka, Phelan & Whitten: Effects of restrictions on advertising and commercial practice in the professions – the case of optometry, FTC, 1980.

(v) Trebilcock, Tuohy & Wolfson, 1979 cited in OECD Roundtable Report (Note 13).

from restrictions on commercial practice, advertising and continuing education for optometrists). In seven studies the impact arising from restrictions on quality was found to be neutral and in five cases they were found to decrease service quality. In one study the impacts were found to be mixed. Overall, therefore, empirical evidence (most of it focussed on advertising restrictions but with some looking at other types of restriction) does not support the contention that quality justifies restriction. It is important to note, however, that the extent of diversity in the methods and conclusions of the studies means that it is not valid to generalise. Each restriction, or set of restrictions, in each profession merits separate analysis.

**Potential impacts on competition from restrictions in the provision of professional services**

67. There are three types of economic theory that can help predict the impact on competition from restrictions imposed within the professions:

- traditional collusion;
- raising rivals’ costs; and,
- raising one’s own costs.

The insights to be gained from examining these three theories are particularly useful for designing a method of testing the impacts of professional service restrictions on competition. For example, the impact on competition from overly restrictive entry requirements could be reduced incentives to innovate or cut costs, rather than higher margins. Chapter III sets out our suggested framework for analysing restrictions on the provision of professional services.

**Traditional collusion**

68. Traditional collusion refers to a direct attempt by suppliers to restrict output and raise prices above marginal cost (the classic case of monopoly pricing with dead-weight losses to consumers in terms of reduced supply of services and higher fees). Collusion may occur with or without the direct involvement of a professional body. Fee collusion, mandatory fee scales, fee guidance and quotas on new entry all fit within this category, provided that “cheating”, e.g. shaving fee rates or expanding output, can be detected and punished (and cheating will be more difficult – or impossible in the case of an entry quota - where a professional body polices the agreement). A recent study by Shepherd<sup>20</sup> of the American Bar Association’s accreditation system for law schools serves to illustrate the traditional collusion theory.

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Table 4 sources continued: (vi) McChesney & Muris: The effect of advertising on the quality of legal services, American Bar Association Journal, 1979.

(vii) Kwoka: Advertising and the price and quality of optometric services, AER 1984.

(viii) Cebula: Does lawyer advertising adversely influence the image of lawyers in the United States? - An alternative perspective and new empirical evidence, Journal of Legal Studies, June 1998.

<sup>20</sup> Shepherd: *Cartels and controls in legal training*, The Antitrust Bulletin, Summer 2000.



69. According to Shepherd, in response to an “overcrowded” market in the 1920s the ABA reduced the pass rate on the bar exam, introduced accreditation of law schools (limited to “elite” law schools) and convinced states to deny practising licences to graduates from non-accredited law schools. Shepherd identified impacts - which persist to this day - on the legal training and legal services markets from this package of direct and indirect entry restrictions.
70. Output is reduced in the legal training market, with fewer law schools and fewer students at these schools (limitations on teaching loads and student-faculty ratios have to be observed in order for a law school to be accredited). The knock-on consequences are higher prices for legal training, inefficient law schools (because they are protected from competition from non-accredited schools), inhibited innovation (because new styles of legal education are prevented), higher profits (because fees are above competitive levels) and injustice (because the system excludes low-income students and increases the debt burden on graduates). As for the downstream legal services market, Shepherd contends that the restricted supply of new lawyers increases the price of legal services. Moreover, the ABA system excludes cheaper and/or lower quality law services and customers on lower incomes. Shepherd argues that the cartel is supported by law schools and that “cheating” is avoided as the higher tuition fees afforded by the cartel more than cover the higher costs of providing a formal “elite” education.

### **Raising rivals’ costs**

71. A different theory, raising rivals’ costs, can be applied to restrictions that serve to foreclose a professional service market to potential new entrants by raising their marginal costs more than the average costs of the collusive group (in this case, the members of the professional body). Types of restriction that may fit best under this theory are direct entry restrictions as to qualifications and/or experience, although in extreme cases – where there are explicit quotas, for example - the traditional collusion theory may be more relevant; reservation of professional titles; and demarcation of services. All these may create barriers to entry by raising the costs of “outsiders” (the unqualified or untitled, for example) more than insiders.
72. Important lessons from this theory are that monopolistic gains may be enjoyed in terms of professionals enjoying an “easy life” (not attempting to remain cost efficient, for example) rather than pricing above marginal cost. Cheating will only occur if professionals perceive that the costs of supporting the restrictions outweigh the benefits of a shelter from competitive new entry. A strategy of raising rivals’ costs has advantages over predatory pricing in terms of credibility (it can be profitable even if rivals remain in the market since rivals’ higher costs create an incentive to cut back output and raise prices) and also because rivals can be disadvantaged without the need to set low prices (they are hit by higher costs instead).

### Raising own costs

73. The raising own costs theory refers to a situation where professionals impose restrictions on their own behaviour (or that of their clients) with the result that their costs increase and output contracts. Although it runs at first sight counter to common sense, this theory shows that under certain circumstances (which we describe in the next paragraph) the profits of these professionals are enhanced. Examples of restrictions that are likely to fit this theory are restrictions on advertising and/or marketing and restrictions on permitted business structure (although the raising rivals' cost theory may also be relevant to the latter)<sup>21</sup>.
74. There are two separate explanations of why this strategy may be profitable. The first relates to consumer demand and consumer search costs. Restrictions on advertising, for example, raise search costs with the result that consumers give up searching before attaining their optimal quality/price combination. Firms exploit what is in effect a more inelastic demand curve (consumers are less sensitive to price changes due to the higher costs of searching for alternatives) by increasing price above marginal cost and extracting more profit than is possible under a more elastic demand curve.
75. The second explanation for profit generation uses the supply-side impacts of an own cost raising strategy. A restriction on advertising (or business structure), leads firms to substitute alternative and more costly forms of competition – for example, trying to attract customers via “reputation-building” actions rather than direct advertising (or forcing customers to go to several different professional firms to obtain a package of services rather than to a “one-stop shop” when the latter is restricted). This is equivalent to an increase in the marginal cost of providing the professional service (for a given price less advertising means fewer customers and fewer sales) – in other words, a leftward shift in the supply curve. If that increase in marginal costs (and thus price) exceeds the increase in average costs, the strategy will be profitable (since profit equals the product of quantity and the difference between price and average costs)<sup>22</sup>.
76. Langenfeld and Silvia<sup>23</sup> set out three conditions for an own cost raising strategy to be successful. Firstly, insiders must possess market power (i.e. there must be inelastic demand for the professional service) otherwise consumers would simply substitute to a lower cost outsider. Barriers to entry as the result of direct entry restrictions or demarcation, for example, may provide a source of market power. Alternatively, clients may face very high switching costs. Secondly, the agreement to raise own costs must be enforceable (and it is likely that

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<sup>21</sup> Other forms of own-cost raising may include limits on bidding (such as a prohibition on negotiation over fees after all the bids have been received) and a ban on contingency fees (may be a more efficient way of sharing risks).

<sup>22</sup> See Langenfeld & Morris: *Analysing agreements among competitors: what does the future hold?*, FTC, 1991.

<sup>23</sup> Langenfeld, JA and Silvia, L: *Federal trade commission horizontal restraint cases: an economic perspective*, Antitrust Law Journal Vol. 61 1993

professionals attempting to advertise their fees will be detected and punished more easily than cheating on a traditional collusion or rivals' cost raising strategy). Thirdly, there must not be a substitute form of competition that is as efficient as the restricted form. Thus, in the example above, a problem would arise if reputation building were as cost-efficient at attracting new business as direct advertising.

77. Langenfeld and Silvia also show that there will be incentives to maintain an own cost raising strategy, once it is in place, even if it is unprofitable. Consider, for example, a ban on advertising that is no longer profitable because of the availability of more sophisticated (and cost-efficient) marketing techniques available only to the insider firms. There would still be pressure to resist relaxing the ban if advertising permitted new entry and forced inefficient insiders out of the market.
78. An indication of the relative importance of each of these three theories is provided by examining previous competition cases. Langenfeld and Silvia identify 81 Federal Trade Commission (FTC) final orders involving horizontal restraints in the period 1980-92 (from about 1980 the FTC began applying competition policy principles to the professions) across a variety of different professional and non-professional sectors (including medical professionals, electrical contractors, pharmacists, accountants, engineers, grocers and house movers). They classify these cases according to the most relevant analytical theory. Table 5 summarises their results:

**Table 5: Classification of FTC competition cases**

<b>Theory</b>	<b>Number of Cases</b>	<b>%</b>
Traditional collusion	21	26
Raising rivals' costs	20	25
Raising own costs	27	33
Combinations of the above	13	16
<b>Total</b>	<b>81</b>	<b>100</b>

79. In 68% of these cases a trade or professional body was the vehicle for the alleged anti-competitive conduct. Langenfeld and Silvia also note that in most of the 81 cases there were a large number of firms involved, market concentration was relatively low and barriers to entry were similarly low. Focusing just on the 27 "own cost raising" cases, they found that most (21) involved advertising restrictions. However, solicitation constraints (8 cases), bidding restrictions (3 cases) and restrictions on affiliation/business structure (4 cases) also featured (cases often involved two or more types of restriction).
80. Two of the three theories discussed above (raising own costs and traditional collusion) predict that restrictions in the professions will increase price. The third, raising rivals' costs, may inflate prices - but benefits from the strategy are

possible with prices remaining at marginal cost. As with the theory on justifications for restrictions, only empirical evidence can establish the actual impact on competition. A variety of different studies (primarily examining the impact of restrictions on price) are summarised in the next section.

**Empirical evidence on the competition impacts from restrictions on the provision of professional services**

81. Table 6 summarises the results from 15 empirical studies covering a variety of different professions and types of restriction (although the majority focus on advertising restrictions).

**Table 6: Empirical evidence on the impact of professional restrictions on competition**

<b>Author</b>	<b>Date</b>	<b>Country</b>	<b>Profession</b>	<b>Restriction</b>	<b>Impact on price</b>	<b>Increase in price</b>
Benham (i.)	1972	USA	Optometry	Advertising	Increase	25%-100%
Benham (ii.)	1975	USA	Optometry	Advertising	Increase	25-40%
Cady (iii.)	1976	USA	Pharmacy	Advertising	Increase	5%
Muris & McChesney (iv.)	1978	USA	Law	Advertising	Increase	-
Shepard (iii.)	1978	USA	Dentistry	Reciprocity	Increase	15%
Feldman & Begun (iii.)	1978/ 1980	USA	Optometry	Advertising	Increase	9-16%
Bond et al. (v.)	1980	USA	Optometry	Commercial practice, Advertising	Increase	33%
Muzondo & Pazderka (vi.)	1980	Canada	20 including Law & Architecture	Direct entry, Mandatory fees, Advertising	Increased Income (fees & adverts.)	10.4% (fees) 32.8% (adverts.)
Cox, DeSerpa & Canby (vii.)	1982	USA	Law	Advertising	Higher price dispersion	-
Conrad & Sheldon (iii.)	1982	USA	Dentistry	Commercial practice, Use of Auxiliaries	Increase	4%
FTC (viii.)	1984	USA	Law	Advertising	Increase	5-11%
Kwoka (ix.)	1984	USA	Optometry	Commercial practice, Advertising	Increase	20%
Haas-Wilson (iii.)	1986	USA	Optometry	Commercial practice	Increase	5-13%
Schroeter et al. (x.)	1987	USA	Law	Advertising	More inelastic demand	-
Liang & Ogur (iii.)	1987	USA	Dentistry	Use of Auxiliaries	Increase	11%

Sources: see footnote 24

82. In every case presented in Table 6<sup>24</sup> there is found to be a detrimental impact on competition from restrictions on the provision of professional services. Twelve studies show an increase in price as the result of restrictions; of the remaining three, one measures the impact of restrictions in terms of higher earnings, another in terms of more inelastic demand and the third in terms of greater dispersion of fees charged.
83. Overall, the evidence clearly shows that professional restrictions can and do have a detrimental impact on competition and on the prices charged to consumers. It is important to note, however, that it is not possible to generalise about the impact of restrictions on competition. Each restriction or set of restrictions in each profession requires separate analysis.

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<sup>24</sup> **Sources for Table 6:**

- (i.) Benham: *The effect of advertising on the price of eyeglasses*, Journal of Law and Economics, 1972.
- (ii.) Benham & Benham: *Regulation through the professions: a perspective on information control*, Journal of Law and Economics, 1975.
- (iii.) Cited in Cox & Foster: *The costs and benefits of occupational regulation*, FTC 1990 p31.
- (iv.) Muris & McChesney: *Advertising, consumer welfare and the quality of legal services*, 1978 – cited in OECD Round Table Report: Chapter 3, Regulatory Reform and Professional Business Services.
- (v.) Bond, Kwoka, Phelan & Whitten: *Effects of restrictions on advertising and commercial practice in the professions – the case of optometry*, FTC 1980.
- (vi.) Muzondo & Pazderka: *Occupational licensing and professional incomes in Canada*, Canadian Economics Association, 1980.
- (vii.) Cox, DeSerpa & Canby: *Consumer information and the pricing of legal services*, JIE 1982.
- (viii.) Jacobs et al.: *Improving consumer access to legal services – the case for removing restrictions on truthful advertising*, Cleveland Regional Office, FTC 1984.
- (ix.) Kwoka: *Advertising and the price and quality of optometric services*, AER 1984.
- (x.) Schroeter, Smith & Cox: *Advertising and competition in routine legal service markets: an empirical investigation*, JIE 1987.

### III The role of competition Policy

84. The empirical evidence reviewed in Chapter II does not provide unqualified support for the maintenance of restrictions in the professional services: many restrictions have, at best, a neutral impact on the quality of services (and are therefore unnecessary) and some clearly distort or inhibit competition. However, neither does the evidence support an indiscriminate eradication of all professional restrictions and a complete reliance on market forces. A balance is therefore required between overcoming market failure and retaining vigorous competition.
85. In this chapter we set out a framework for constructing a trade-off that could be used as part of any subsequent move or moves to reform the regulation of the professions. We have not sought to rigorously employ this framework in our own analysis of restrictions in the legal, accountancy and architecture professions (Chapters IV to VII). Our remit was to focus on the potential impacts of restrictions on competition rather than conduct a full public-interest trade-off (we have, however, noted and discussed the possible justifications for each restriction).
86. The theory and empirical evidence discussed in Chapter II points to the merits of an analytical approach on a case-by-case basis. Competition policy provides a powerful mechanism for addressing the trade-offs involved in reforming professional restrictions - and attaining the best outcome for the public interest. Competition policy will not always be the appropriate vehicle for reform, however, as this depends on the origin of each individual restriction (see Chapters IV to VII). For example, professional bodies themselves may be persuaded to initiate changes to voluntary restrictions or, where a restriction is backed up by statute, the relevant government departments will need to be in the vanguard.
87. A great deal of progress has already been achieved in the past 30 years or so through the application of competition policy and government reforms. Some of the highlights of this programme of reform in the professions are discussed later in this Chapter. As we discuss in detail in Chapters IV to VII, however, there appears to be considerable scope for clearing away unnecessary restrictions still in place, and opening up the professions to the full force of competition. Fortunately, the Competition Act 1998 in conjunction with the complex monopoly provisions of the Fair Trading Act 1973 provide the UK competition authorities with wide-ranging powers and a rigorous analytical framework well suited to the task of pushing forward this programme of reform<sup>25</sup>.

#### **The Fair Trading Act 1973**

88. A complex monopoly situation under the Fair Trading Act 1973 (FTA) exists where a group of undertakings which are not connected and which together

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<sup>25</sup> Professional restrictions which may affect trade between EU Member States will also be caught under EU competition law (in particular, Articles 81 and 82).

account for at least 25% of the UK market engage in conduct which has, or is likely to have, the effect of restricting, distorting or preventing competition.

89. Action under the FTA is most likely in cases where the alleged anti-competitive conduct is not caught under the Competition Act 1998 (see below). For example, where a group of undertakings all adopt similar practices or engage in parallel behaviour which appears to be anti-competitive, but where there is no evidence of collusion or agreement. An example might be where a group of the largest firms in a profession (together supplying more than 25% of a particular set of services) all adopt the same high qualification hurdles for entry to the profession, and there is reason to believe that the restrictions have a significant effect on competition (but there is no evidence of an agreement or collusion between the firms).

### **The Competition Act 1998**

90. Chapter I of the Competition Act 1998 (CA98) prohibits agreements between undertakings, decisions by associations of undertakings, or concerted practices which have as their object or effect the prevention, restriction or distortion of competition. Chapter II prohibits conduct on the part of one or more undertakings, which amounts to the abuse of a dominant position.
91. Professional bodies and individual professionals may be thought of as undertakings or associations of undertakings under Chapter I, or as undertakings under Chapter II. Moreover, the ‘agreements’, ‘decisions’ and ‘concerted practices’ prohibited under Chapter I embrace professional restrictions - whether in a written code of practice, a constitution or verbally recommended.
92. Under the CA98, some types of restriction – such as price fixing through a mandatory fee scale - are likely to be ‘*per se*’ breaches. For most, however, the key test under Chapter I will be whether the professional restriction produces an appreciable effect on competition and, if so, whether:
- An exemption is justified on grounds that the restriction also improves either production, distribution or economic progress (e.g. by helping to address a market failure due to an asymmetry of information between professionals and their clients);
  - A fair share of this benefit is passed on to consumers;
  - The restriction is indispensable to the achievement of those benefits (e.g. there are no other means – less damaging to competition - of overcoming the market failure); and,
  - Competition isn’t completely eliminated for a substantial part of the market.
93. Examples of restrictions in the professions that could be subject to this test include restrictions on advertising, rigidly enforced codes of practice or standard terms and conditions, and entry requirements that are opaque, disproportionate, discriminatory and non-objective. The Chapter I prohibition described above would **not** apply to rules of professions listed in Part II of Schedule 4 of the CA98

that had been notified to, and designated by, the Secretary of State for Trade and Industry. Those professions, the professional rules of which are eligible for exclusion by designation, are listed in Schedule 4. They include solicitors, barristers, architects, accountants, insolvency practitioners, engineers, patent agents, dentists, the medical profession, ministers of religion and providers of education and training.

94. Accordingly, we make an overall recommendation that the Competition Act 1998 should be extended to cover in full the professions<sup>26</sup> (see Chapter IX). In so doing, the complex trade-offs described above will be addressed on a case-by-case basis to ensure that the regulation of the professions best serves the public interest.

### **A framework for the economic analysis of restrictions**

95. Figure 1 presents the individual stages of an analysis of restrictions. This framework is not intended to be comprehensive. If restrictions were being examined as part of a competition policy investigation, for example, the competition authority would usually define the relevant economic markets and have to be satisfied that the restriction had an appreciable effect on competition<sup>27</sup> before proceeding further. The framework set out here might be incorporated into the subsequent analysis - aimed at testing whether a restriction that has an appreciable effect on competition also improves production, distribution or economic progress (e.g. by overcoming a market failure), and that a fair share of this benefit is passed on to consumers. Our suggested framework could help determine whether the particular restriction under investigation is indispensable to the achievement of those benefits, i.e. that there are no alternative arrangements that could tackle the market failure without inhibiting competition to the same extent<sup>28</sup>.
96. Alternatively, this economic framework may be utilised by the Competition Commission as part of a reference under the complex monopoly provisions of the Fair Trading Act (paragraphs 88 to 89).

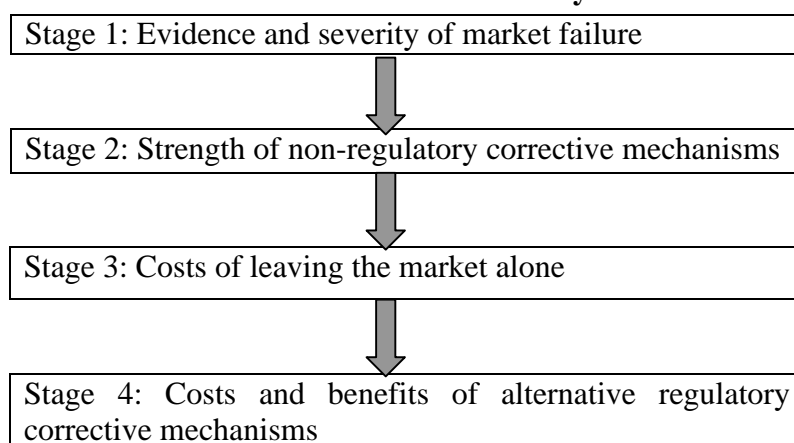
<sup>26</sup> Indeed, the professions are not excluded from the scope of EU competition law. See, for example, Cases C-180/98 to C-184/98 Pavel Pavlov (AG's Opinion of 23/3/00) and Case C 35/96 Commission v Italy.

<sup>27</sup> See, for example, OFT Guidelines on the application of the Competition Act 1998 and, in particular, OFT401 and OFT408.

<sup>28</sup> The US competition authorities are pioneering an approach known as the "truncated rule of reason" that puts less emphasis on the definition of markets and analysis of market power, and rather more on the framework set out here. Annex C discusses in more detail.



**Figure 1: A framework for the economic analysis of restrictions**



97. The first step is to determine the existence and severity of any market failure in the provision of a particular professional service (see Chapter II). The second step is to assess the viability and effectiveness of non-regulatory mechanisms that may serve to correct for any market failure (Chapter II). Thirdly, the cost of leaving the market free of regulation in the presence of market failure needs to be established. The final step is to identify and then analyse the relative costs and benefits of different forms of regulation that may be used to address market failure.

**Stages 1 and 2: market failure and non-regulatory corrective mechanisms**

98. The primary cause of market failure in the provision of professional services is asymmetric information, that is to say an imbalance of information between supplier and buyer. In particular, there is a danger that service providers will reduce quality of service, knowing that consumers may not be able to detect or measure it. A second source of market failure is externalities – impacts on third parties from decisions made by the professional and the client. But, as we discussed at some length in Chapter II there are a variety of mechanisms that may help compensate for market failure in the absence of regulation. Examples include litigation (and the threat of litigation), repeat purchases and the value of reputation. An initial assessment of the severity of any market failure and the degree to which this is or can be corrected by non-regulatory mechanisms should form the basis of any reform programme.
99. The results of such an examination are likely to differ from case to case – and, more generally, according to the type of consumer and the type of service involved. The optimum balance between competition and regulation to address market failure will vary accordingly. For example, large corporate customers are likely to have superior information about the quality of services - as they make regular repeat purchases and possess the resources necessary to monitor quality. As a result, such consumers may not require the same degree of quality protection as do small consumers (because reputation effects are likely to be stronger among

the larger clients). Moreover, to the extent that the services demanded by corporate clients involve a high degree of judgement, straightforward price competition and fee advertising may not have quite as significant a role to play as for an individual private buyer. Larger buyers may obtain most value from reforms that permit the maximum competition in non-price factors such as flexible and innovative service offerings (and in the productive efficiency, or cost effectiveness, of professionals).

100. Private consumers, on the other hand, are likely to buy professional services infrequently and most will lack the resources to monitor the quality of those services. Market failure ascribable to information asymmetry is more likely in such cases and the case for some form of quality protection is correspondingly stronger, although it will still be important to check on a case-by-case basis for the existence of non-regulatory corrective mechanisms such as the availability of third-party consumer information. Some types of service purchased by individual consumers, however, may lend themselves well to price competition and marketing if they are of a fairly routine and standardised nature, or where it is easy for consumers to judge the role of the service they are paying for in the ultimate outcome. In such circumstances, quality protection measures will need to be targeted so as to avoid interfering with advertising and fee competition. One reform here might be the imposition of two professional codes of practice: one for private clients and/or standardised services, and one for corporate customers and/or complex services.

#### **Stages 3 and 4: regulation or no regulation**

101. Once the type and severity of market failure for a particular service has been identified and the actual or potential role of non-regulatory correction determined, subsequent analytical steps need to involve an assessment of the net benefits of different types of regulation. The “no-regulation” option should be included in this assessment. Regulation, whether administered by a professional body or directly by government, is not automatically the best means of overcoming any residual market failure. The regulator may face the same informational difficulties, for example, as consumers. In that case, the role for government may be to promote non-regulatory mechanisms for addressing market failure, such as subsidising the acquisition of quality information by consumers. Alternatively, the costs of using regulation to correct a residual market failure may outweigh the costs that occur when some customers misjudge service quality and make an inappropriate purchase. Such will normally be the case for the services of (say) a painter and decorator, but may also apply to specific professional services.
102. Assuming that the “no-regulation” option has been ruled out, there are questions of how to use regulation to tackle a market failure without unduly distorting competition:
- Should a profession be permitted to regulate itself - or is there an inherent conflict of interest with self-regulation?

- Should the providers of a particular legal service, for example, be licensed or would certification or registration be better for consumers?

### **Who should do the regulating?**

103. With respect to the first of these questions, we outlined in Chapter II some important reasons why professional bodies may have strong incentives to use their regulatory powers to inhibit competition and thereby enable their members to raise incomes or enjoy “an easier life” (or prevent the reform of restrictions that are having these effects). In that earlier discussion we also noted that an argument in favour of some form of self-regulation was the fact that professionals are themselves often in the best position to gauge the degree of regulation necessary to preserve adequate quality standards.
104. In general we are in favour of a much greater involvement by outside agencies and/or consumer bodies in the regulation of the professions. In this way, the preservation of effective competition can be made as integral to regulatory decisions as the correction of information asymmetries between professionals and their clients. Accordingly, we recommend in Chapter IX that the professions should be subject to the full force of competition law in the same way as other sectors of the economy - and therefore subject to potential review by the competition authorities (the Office of Fair Trading and the Competition Commission). This reform alone should go some way to addressing the concerns we have identified in our review of the legal, accountancy and architecture professions. It should also ensure that future regulatory decisions by professional bodies are taken strictly in the public’s best interests.

### **Alternative restrictions**

105. The answer to the second question – concerning the appropriate form of regulation - can only be answered on a case-by-case basis, as part of a competition policy investigation perhaps. For example, market failure in the provision of tax advice could be addressed by allowing consumers to choose between certified accountants (with a high level of qualifications and high fees) and non-certified accountants (with a lower level of qualifications but lower fees) according to the consumer’s budget, the complexity of the advice required and the risks and costs of receiving inadequate or inappropriate advice. This arrangement could adequately address market failure whilst permitting competition between types of accountant.
106. On the other hand, a strict licensing regime - whereby only accountants with a prescribed level of qualifications are permitted to provide advice - could also tackle market failure (though not if a segment of consumers with limited budgets are excluded from the market altogether). But excluding other types of accountant from the market for tax advice licensing could also unduly inhibit competition between accountants, with potential impacts including high prices, limited choice and lack of innovation. For statutory audit, however, licensing may be in the

public's best interest because in that case the negative externalities may be costly enough to warrant the limitation on competition.

107. In the next section, we summarise some of the reforms recommended by UK (and foreign) competition authorities in the past. Before doing so, however, we list some suggestions for regulatory responses to a general set of circumstances (but we must reiterate that only a case-by-case examination can establish the right regulatory response or responses at a detailed level). We use the four headings of general reforms, direct entry, demarcation and conduct, and where relevant quote a source of analysis and recommendation.

### **General reforms**

- Remove professions' exemption from general competition law (Australian Trade Practices Commission report on the legal profession, 1994).
- The long traditions and established culture of many professions may require that liberalisation be accompanied by positive encouragement to change actual practices and behaviour (Shapland and Sorsby, 1996).

### **Direct entry**

- Certification need not entail entry controls at more than one level. For example, qualification requirements and accreditation only of certain educational providers may be excessive (OECD Roundtable report).
- Reservation of a professional title may be acceptable if it facilitates consumer choice and does not reinforce a demarcation of services (Australian Trade Practices Commission report on the architecture profession, 1992).

### **Demarcation**

- Exclusive demarcation may be justified only for services where there is asymmetric information, a need to protect quality, and the possibility of substantial ill effects for the client and for third parties (OECD Roundtable, May 1999).
- Possible alternatives to exclusive demarcation include certification, output monitoring, registration and mandatory disclosure (Cox and Foster, 1990).
- Certification allows anyone to practice but offers formal certificates of competence to those who desire them and who meet specified standards of competence. Certification, however, suffers from the same problems as licensing in terms of its focus on inputs that may not improve quality (Cox and Foster, 1990).
- Output monitoring sets standards of competence, monitors compliance via spot checks and penalises violations. This method may, however, be costly to administer and will only apply to services with objective measures of quality (Cox and Foster, 1990).
- Registration allows anyone to practice so long as he or she registers with an appropriate authority. The threat of revocation disciplines quality provision

but may allow low quality providers to escape detection if quality is difficult to measure (Cox and Foster, 1990).

- Mandatory disclosure refers to a regulatory requirement for professionals to disclose certain information to consumers (e.g. a criminal record). This method is of limited use, however, if the disclosures do not allow consumers to gauge the quality of services (Cox and Foster, 1990).
- Restrictions on types of business structure should be relaxed provided that other protection is in place against conflict of interest and liability issues and provided that the new structures offer genuine advantages in terms of efficiency, access to capital and management flexibility (OECD Roundtable report).
- Conflict of interest concerns may be addressed directly using rules on liability insurance and full disclosure backed up by disciplinary proceedings or litigation (OECD Roundtable report).

### **Conduct**

- Fee guidance may be acceptable where charges are determined independently and objectively, charges reflect changing market conditions and professionals and clients are clearly free to negotiate (OECD Roundtable report).
- Protection of low-income consumers may be better achieved via insurance or via special “at-cost” arrangements with the professional body than by maximum fee rules (OECD Roundtable report).
- Advertising could help convey information on fees to consumers for routine services (Shapland and Sorsby, 1996).

### **Highlights in the history of reform of the professions**

108. Prior to the Competition Act 1998 (discussed above), the professions in the UK were subject only to the monopoly provisions of the UK competition legislation (the restrictive trade practices legislation did not apply to the professions) and to EU competition law. Under the former legislation, there was a major review of the professions by the Monopolies and Mergers Commission (the MMC, now called the Competition Commission) in 1970. This report triggered off a whole series of subsequent reports by the MMC (see Annex B).

#### **MMC report into restrictions in the professions, 1970<sup>29</sup>.**

109. This MMC investigation was given a very wide remit to examine all types of restriction across a large number of the professions. The only restrictions excluded from its remit were practices expressly authorised under statute enacted after 1955, and standards of proficiency required for entry to a profession. Unfortunately, the MMC was unable to make a final judgement on particular practices or on their general effect precisely because of the breadth of scope of the investigation, and the different circumstances for each restriction in each profession (providing further support for our suggested case-by-case approach to

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<sup>29</sup> ‘A report on the general effect on the public interest of certain restrictive practices so far as they prevail in relation to the supply of professional services’, (Cmnd.4436).

the economic analysis of restrictions outlined earlier). Nevertheless, some very useful guidelines emerged for testing whether restrictions are justified.

110. The types of restriction under examination by the MMC were essentially the same as those under review in this report:
- Entry restrictions and demarcation (tests that discriminate between the qualified and unqualified that may, in practice, have excluded the unqualified from practising);
  - Fees (mandatory regulation of prices and recommended scales);
  - Prohibitions on certain business structures (particularly limited liability);
  - Restrictions on practice in another profession or in partnership with another profession (including the multi-disciplinary partnership (MDP) issue); and,
  - Advertising restrictions.
111. The MMC assessed the potential impacts on competition from these restrictions in terms of barriers to entry and existing forms of competition. For example, with respect to the former the MMC stated that *“competition from new entrants is restricted to a significant extent in the professions insofar as there are standards of qualification which either debar the unqualified from practising at all or effectively deny or hamper access by the unqualified to some parts of the market for the relevant service”* (paragraph 283). In terms of the restrictions on conduct the MMC’s view was that *“in most professions there are in addition certain methods of competition (e.g. competition in price, competitive advertising), that are barred to practitioners”* (paragraph 283). The report then went on to say (in paragraph 284): *“Collective arrangements which significantly limit the freedom of the parties in the conduct of their businesses may be expected in some degree to result in higher prices, less efficient use of resources, discouragement of new developments and a tendency towards rigidity in the structure and trading methods of those businesses. Such collective restrictions tend to reduce the pressures upon those observing them to increase their efficiency. They may also delay the introduction of new forms of service and the elimination of inefficient practitioners.”*
112. On the other hand, the MMC recognised that there may be valid justifications for restrictions on competition. The MMC summed up the underlying problem in terms of sellers of professional services having to subordinate their self-interest to the client’s and public’s interest as the result of purchasers being poor judges of their self-interest. However, the MMC contended that *“this general case we cannot accept as applying to all professions or to all types of restriction”* (paragraph 289). Instead, the MMC asserted that *“the normal safeguards are regulatory or prohibitive legislation, the possibility of civil action against the supplier, the fear of adverse publicity and the standard of integrity of the supplier”* (paragraph 291). Moreover, it was *“necessary to consider whether controls on competition might not themselves create distrust and suspicion”* (paragraph 300).

113. The MMC’s initial presumption, therefore, was one of scepticism. They recognised the potentially damaging impacts of restrictions on competition and the public interest and took the view that in many cases there were alternative mechanisms in place to address the underlying market failures. The MMC recommended a case-by-case analysis of each professional restriction in order to establish whether particular restrictions were justified. The MMC’s discussion of particular types of professional restrictions also contained some useful insights.

### **Entry restrictions**

114. The MMC adopted the principle that recognisable qualifications are in the public interest but that consumers should also be able to choose an unqualified practitioner (except in cases where there high costs from poor service or significant externalities). They also considered that the presence of ex-ante quality control in the form of entry restrictions weakened the case for additional conduct restrictions.

- *“We accept that in general it is in the public interest that there should be a qualification the possession of which can be recognised by the public and which therefore has some restrictive effect on entry”* (paragraph 307).
- *“We think that it is against the public interest that the unqualified should be barred from offering a service except where the service involves risk of a specially serious kind and degree to clients who are unable to assess the danger of using the services of unqualified practitioners, or to the interests of third parties”* (paragraph 310).
- *“[it] does not follow that the unqualified should be prohibited from offering (in competition with the qualified) other services which do not involve this risk”* (paragraph 312).
- *“the existence of strict control of entry, for instance, might seem to weaken the case for controlling methods of competition among those who have been permitted entry”* (paragraph 302).

### **Fees**

115. The MMC were unequivocal in their condemnation of mandatory fee guidance. They were dismissive of justifications in terms of the provision of certainty to consumers – particularly where consumers were also free to purchase services from an unregulated practitioner.

- *“The introduction of price competition in the supply of a professional service where it is not at present permitted is likely to be the most effective single stimulant to greater efficiency and to innovation and variety of service and price that could be applied to that profession”* (paragraph 314).
- *“We do not regard the arguments that price regulation provides certainty of price or protection for small clients as affording any such powerful justification”* (paragraph 316).
- *“Price competition might create serious dangers in relation to quality of services of a particularly personal nature or of whose quality the public is*

*generally incapable of judging.... Such a case would be likely to be exceptional” (paragraph 317).*

- *“Exceptional danger of such kinds [as in paragraph 317] are most unlikely to occur when the unqualified are (or should be) free to practice in competition with the qualified” (paragraph 320).*

### **Business structure**

116. The MMC report was generally in favour of liberalising restrictions on permitted business structure.

- *“No clear evidence, however, that removal of these restrictions would necessarily jeopardise the other elements in the personal and fiduciary relationship between practitioner and client” (paragraph 325).*
- *“We do not think than any one of these forms of entity [individual, partnership or a company with limited or unlimited liability] necessarily provides a better financial safeguard than the others” (paragraph 325).*
- *“The restrictions could involve a serious loss of efficiency in some cases” (paragraph 326).*

### **MDPs**

117. The MMC saw a potential role for MDPs and advantages in terms of cost economies and the provision of a ‘one stop shop’, and did not think that problems over conflicts of interest would necessarily arise as a result.

- *“Where particular justifications are advanced, they rest mainly on the need to avoid conflicts of interest and a reduction of choice of practitioners” (paragraph 332).*
- *“There could be advantage to the client in being able to obtain all the advice required from a common source...Restrictions which prevent this can involve disadvantages to users of the services and the sacrifice of such economies as might arise from the joint supply of related services” (paragraph 334).*
- *“The likelihood of a conflict of standards or of interests also seems to us remote in such cases” (paragraph 335).*

### **Advertising**

118. Finally, with respect to advertising, the MMC saw significant advantages from liberalisation.

- *“Freedom to approach the client in this way might be preferable to enforced dependence upon personal recommendation. Overt and therefore challengeable claims made by way of promotion might have some advantages over restrictive rules that inevitably leave loopholes for word-of-mouth promotion which is not open to challenge. In such cases freedom to advertise could also provide an incentive to new entry to the profession as well as to efficiency of service, the introduction of new forms of service and the elimination of less efficient practitioners” (paragraph 344).*

119. As discussed earlier, this wide-ranging report by the MMC in 1970 triggered off a series of eleven more focussed MMC reports looking at particular types of



restriction in particular professions. We have summarised eight of these in Annex B (the three MMC reports not discussed in the Annex concerned advertising restrictions on veterinary surgeons, surveyors and stockbrokers, respectively):

- (1) Advertising restrictions on advocates (Scotland).
- (2) Advocates: Senior Counsel and Juniors (Scotland).
- (3) Advertising restrictions on solicitors (Scotland).
- (4) Advertising restrictions on solicitors (England and Wales).
- (5) Advertising restrictions on barristers (England and Wales).
- (6) Barristers: Queen's Counsel and Juniors (England and Wales).
- (7) Advertising restrictions on accountants (England and Wales).
- (8) Restrictions on fees charged by architects.

120. In nine out of the eleven reports (the exceptions were advertising restrictions on barristers and advocates) the MMC found the restrictions to be operating against the public interest.

### **Other UK reforms**

121. Competition policy has been a major stimulus for reform in the professions (particularly reforms targeted at restrictions on conduct, such as fee setting and advertising). However, to the extent that the origin of many restrictions in the professions is statutory, Government has also instituted a great deal of reform. By way of example, the key milestones in the on-going reform of the legal profession are listed below.

### **Key landmarks in reform of legal profession**

- *1960s*: Three reports on legal profession by National Prices and Incomes Board.
- *1970s*: Three reports by the MMC (see above).
- *1974*: Solicitor's Act. Statutory basis for regulation of solicitors by the Law Society; gives solicitors monopoly over litigation and other reserved activities.
- *1979*: Royal Commission on Legal Services (the Benson Committee). Proposed no radical changes to the legal profession. Recommends continuation of divided profession, Bar's monopoly over advocacy in higher courts and solicitors' monopoly over litigation.
- *1985*: Administration of Justice Act. Breaks solicitors' monopoly on the provision of conveyancing services.
- *1989*: Three Green papers propose radical change for the legal profession including extending advocacy rights and giving direct access to Bar. Following opposition by the judiciary and legal profession, the subsequent White papers are less radical.
- *1990*: Courts and Legal Services Act (CLSA). Implements measures in White paper and creates machinery by which professional bodies can be authorised by Lord Chancellor to grant rights of advocacy and to carry out litigation. Ends the Bar's monopolies over advocacy in higher courts and the solicitors'

monopoly over litigation. Allows professional bodies to decide on other changes e.g. permitting MDPs, direct access to the Bar.

- *1990s*: CLSA has some limited effect e.g. Institute of Legal Executives authorised to grant right of audience; Chartered Institute of Patent Agents to grant audience and litigation rights. But procedure to extend rights of audience very cumbersome. Take-up of new rights by solicitors very slow.
- *1998*: White paper *Modernising Justice*. Aims to facilitate extension of rights of audience and to carry out litigation, and to encourage transferability between two main branches of legal profession. Recommended reform of the authorisation procedure to prevent professional bodies impeding change.
- *1999*: Access to Justice Act passed, implementing White Paper. Bar Council and ILEX become authorised to grant litigation rights. All barristers (including CPS and employed barristers) and solicitors have full rights of audience subject to the qualification requirements of the professional body.
- *1999*: New Civil Procedure Rules (the Woolf reforms) introduced. Aimed at reducing legal costs and speeding up civil justice.
- *1999*: Report on the Operation of the Appointments Procedures in relation to all Judicial Appointments and Queen's Counsel (the Peach report). No major recommendations due to restricted terms of reference.

### **Reform of the professions in other countries**

122. A recent OECD roundtable report<sup>30</sup> discussed the extent to which different member nations have succeeded in reforming the supply of professional services. The type of restrictions in place are fairly common across different countries but programmes of reform are at very different stages (Chapter II sets out the types of restrictions in place across the OECD). The increasing application of competition policy to professionals is singled out by the OECD as a significant driver of these reforms. Constitutional reforms, such as changes in the application of general statutes under-pinning professional bodies, are another key source of change.
123. Two reports in particular are worth noting. The Australian Trade Practices Commission (TPC) examined the professional restrictions imposed on the architecture profession in 1992 and the legal profession in 1994. Given that many of the features of both these professions at the time were similar to those in the UK, the TPC's conclusions are particularly germane. In the case of the legal report, for example, the removal of the lawyers' monopoly on conveyancing and the barristers' monopoly on courtroom work, combined with a liberalisation of restrictions on advertising, are estimated to have resulted in a 12% fall in overall legal costs<sup>31</sup>.

<sup>30</sup> OECD Round Table Report: Chapter 3, Regulatory Reform and Professional Business Services (focus on lawyers, accountants, architects and engineers).

<sup>31</sup> *Ibid.*, p125.

**TPC (Australia) report on the architecture profession<sup>32</sup>**

124. The TPC recommended the following reforms:

- Restrictions on factual and accurate advertising should be eliminated;
- Fee guidance could remain (there was evidence that actual fees diverged considerably from the guideline fees) provided that the architects' professional body made it explicit that they formed the basis for subsequent negotiation;
- The reservation of the title "architect" was in the public interest provided consumers were kept informed of its significance, and given that non-architects were not prevented from competing; and,
- The rule requiring that at least 50% of a practice must be architects should be scrapped in favour of a requirement that all architectural work be under the control and supervision of an architect.

**TPC (Australia) report on the legal profession<sup>33</sup>**

125. The TPC examined a combination of structural restrictions and conduct restrictions imposed on solicitors and barristers in Australia. Examples of the former included restrictions on entry and permitted business structure, and the functional separation between solicitors and barristers. Conduct restrictions included the use of fee scales and restrictions on advertising. Restrictions under review that were specifically imposed on barristers included the prohibition on direct contact with most types of client, and the rule that barristers must operate as sole practitioners.

126. The TPC had two overall conclusions:

- *"Public interest objectives should be pursued directly through ethical and professional rules and disciplinary arrangements, rather than by imposing restrictions on the normal commercial and market behaviour of lawyers"* (1.3, p7); and,
- The Trade Practices Act 1974 should apply in full to the market conduct of lawyers and the rule making and other activities of its professional bodies.

127. With respect to entry restrictions, the TPC recommended that licensing (i.e. the reservation of an area of work to certified practitioners only) should only apply where there was asymmetric information, high costs to the client from poor quality service delivery and externalities (and all areas of work should be assessed on this basis). The TPC advised that the functional separation between barristers and solicitors should be eliminated, along with the prohibition on direct access to most clients by barristers and the rules preventing the formation of MDPs and incorporated practices.

<sup>32</sup> Trade Practices Commission: *Study of the Professions – Architects*, Final Report September 1992.

<sup>33</sup> Trade Practices Commission: *Study of the Professions – Legal*, Final Report March 1994.

128. In terms of the conduct restrictions, the TPC contended that fee scales (adjusted through indexation) were not effective indicators or market prices and should be scrapped. Advertising restrictions should also be eliminated so that lawyers were free to inform clients and attract business by advertising, promotion, testimonials, endorsements and inter-firm comparisons. Finally, the TPC recommended that the official selection and endorsement of Queen's Counsel should end on the basis that their clients (who were generally highly sophisticated) did not require a quality mark and the system risked compromising the independence of barristers from government.
129. In subsequent chapters (Chapters IV to VII) we examine in detail the restrictions currently in place for three professions: law (solicitors and barristers are considered separately in Chapter IV and V respectively), accountancy (Chapter VI) and architecture (Chapter VII). In Chapter VIII we list (but do not analyse) some of the issues arising as a result of restrictions imposed within the insolvency practitioner profession. It is important to reiterate once again, that our remit was limited to an assessment of the likely impacts on competition arising from restrictions in these professions (see the Introduction at Chapter I). We have not, therefore, applied the framework set out in this chapter but have instead provided a suggested short-list of restrictions for possible full public interest assessment in the future see Chapter IX for a summary of our recommendations.

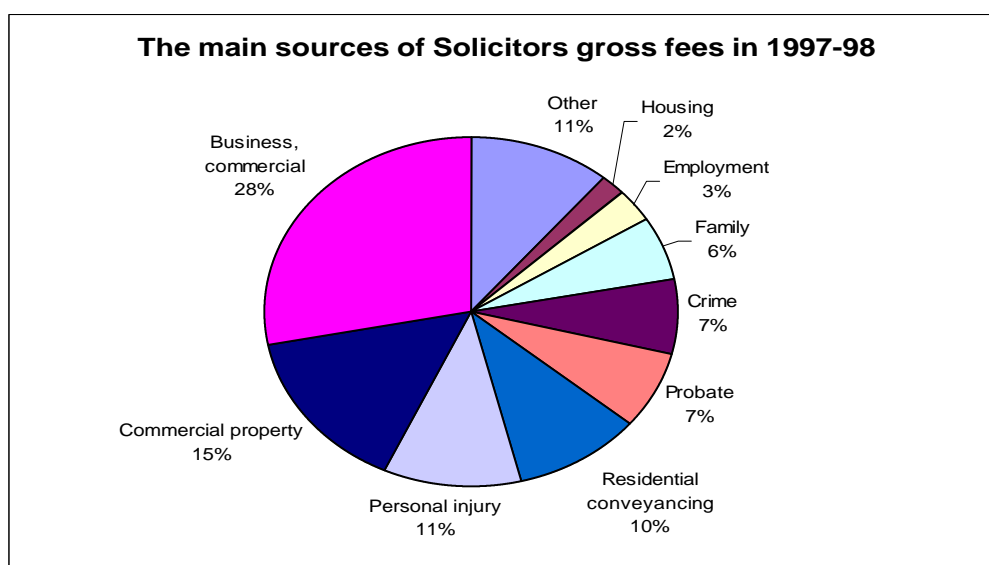
## IV Restrictions in the legal profession: solicitors

### Economic characteristics

#### Services

130. The main sources of solicitors' fees appear to be relatively diverse (see Figure 2), with a wide range of services contributing to total fee revenue. The category that contributes most to total fee revenue is business and commercial law – itself a range of services - with a 28% share<sup>34</sup>.

Figure 2



Source: Trends in the Solicitors Profession 1995-99

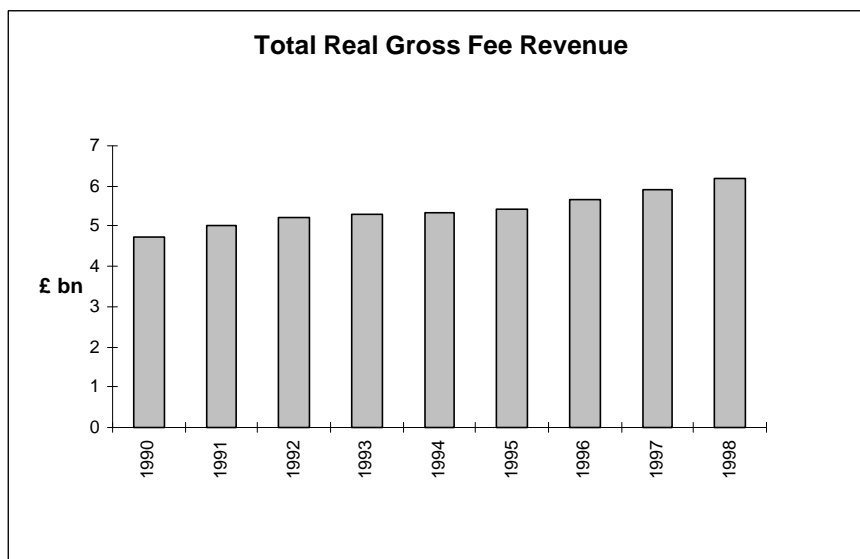
#### Fees and profits

131. Solicitors' total real fee revenue (see Figure 3) has experienced consistent increases over the last ten years, with total gross fee revenue growing from £4.7 billion in 1990 to £6.2 billion in 1998<sup>35</sup> (a 31% increase in real terms). The year on year percentage increases have averaged 4% over the last ten years. This trend seems to be relatively stable, with no year showing a particularly large increase.

<sup>34</sup> Source: The Law Society.

<sup>35</sup> Source: Trends in the Solicitors Profession, 1995-1998, The Law Society and Economic Trends Annual Supplement 1999.

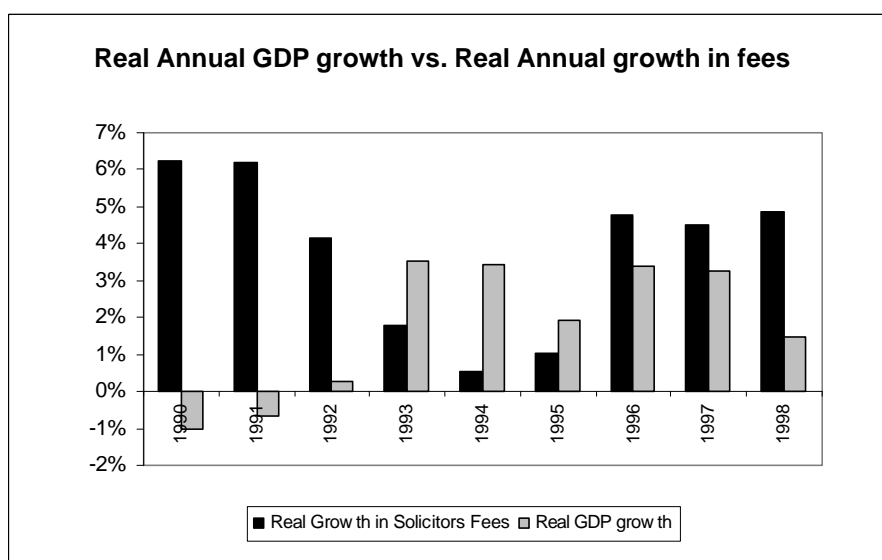
**Figure 3**



Source: Trends in the Solicitors Profession 1995-98

132. In 1998, real growth in total fees was some 3.5 percentage points greater than real growth in GDP<sup>36</sup> (see Figure 4). In fact, real growth in fees has exceeded real growth in GDP, in six of the last nine years (in 1990, for example, real growth in fees was 7 percentage points greater than real growth in GDP).

**Figure 4**

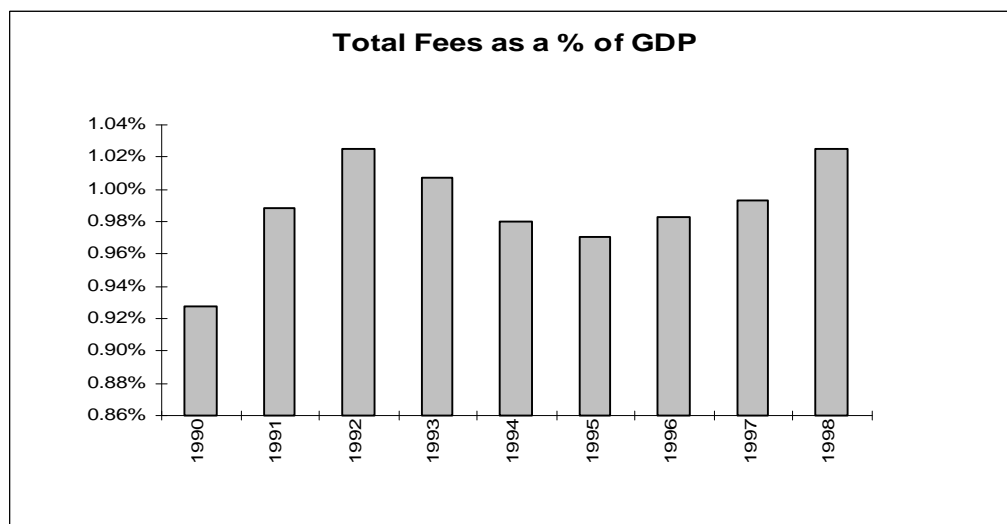


Source: Trends in the Solicitors Profession 1995-98 and Economic Trends 1999 Annual Supplement (ONS)

<sup>36</sup> Source: Trends in the Solicitors Profession, 1995-1998, The Law Society and Economic Trends Annual Supplement 1999

133. We can see a more dynamic picture when we analyse the growth in total fees as a percentage of GDP (see Figure 5). This trend peaks in 1992 when fees represented 1.03 % of UK GDP, tailing off in the mid-1990s and rising again to 1.02% in 1998<sup>37</sup>.

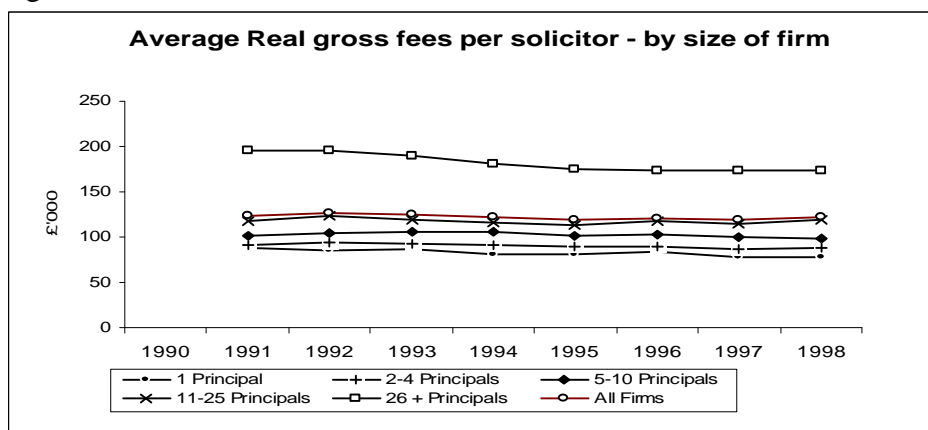
Figure 5



Source: Trends in the Solicitors Profession 1995-99 and Economic Trends 1999 Annual Supplement (ONS)

134. We have also examined the growth of fees by size of firm (see Figure 6). Our data shows that the large (26+ principals<sup>38</sup>) firms have considerably higher fees per solicitor over the period, and in general, the larger the firm, the higher the fee per solicitor.

Figure 6



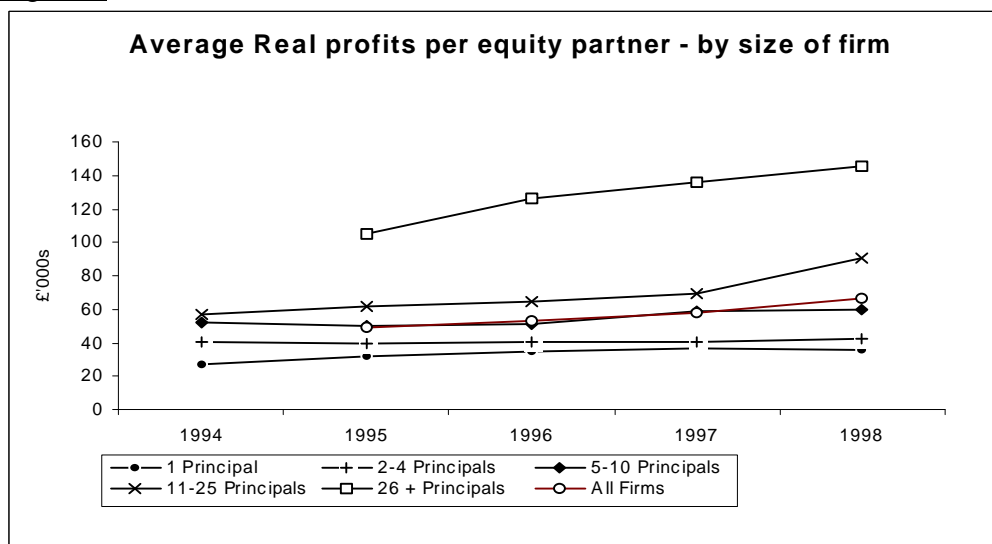
Source: Trends in the Solicitors Profession 1995-99

<sup>37</sup>Source: Trends in the Solicitors Profession, 1995-1998, The Law Society and Economic Trends Annual Supplement 1999.

<sup>38</sup> A “principal” is defined as an equity or salaried partner.

135. Profit levels per equity partner (see Figure 7) show a similar pattern to that of gross fees. Large firms (26+ principals) generate considerably higher profits per equity partner over the period. In general, profits per equity partner are higher the larger the firm.

Figure 7



Source: Trends in the Solicitors Profession 1995-99 and Economic Trends 1999 Annual Supplement (ONS)

### Market structure

136. The market for solicitors' services overall appears to be far from concentrated - with a Herfindhal Index of 315 for the top 100 firms ranked by turnover. As such, the top 5 firms, or the so-called 'Magic Circle',<sup>39</sup> had a combined market share of 31.9% in 2000<sup>40</sup>, and the top 10 firms had a market share of 46.8% by turnover (see Figure 8). In respect of concentration, these figures compare favourably with other professions, especially accountancy where the top 5 firms have a market share in excess of 70%<sup>41</sup> (see Chapter VI). Currently, Clifford Chance is the largest firm by turnover, with a market share of 9.7%.

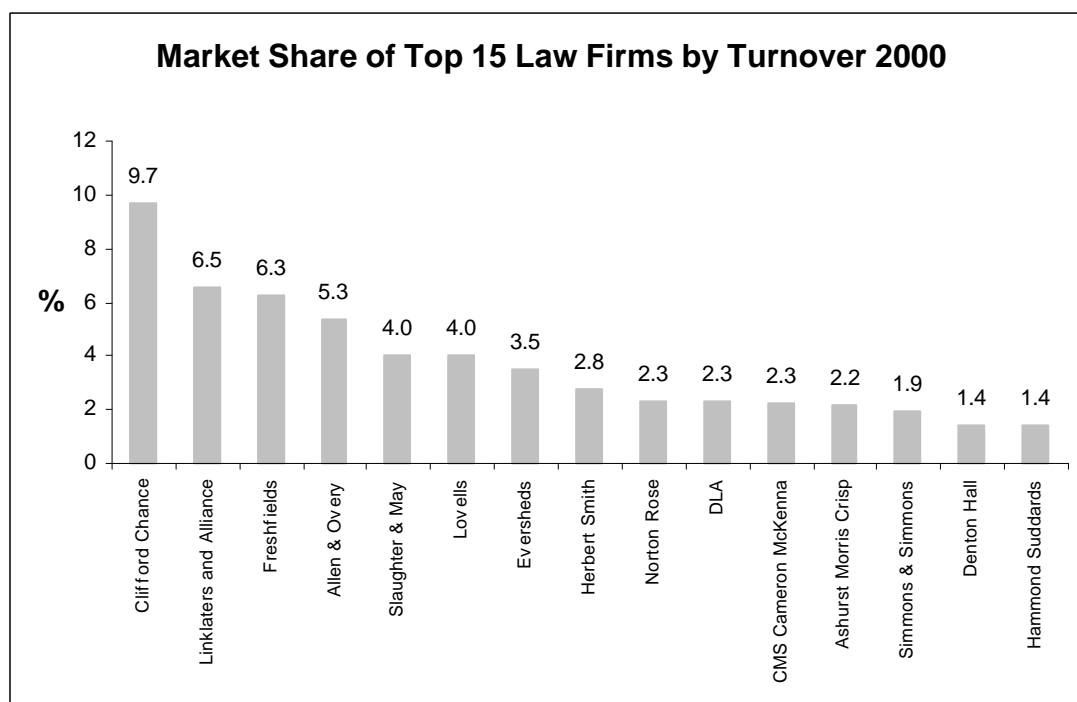
<sup>39</sup> Not our term but one adopted within the profession.

<sup>40</sup> Source: The Lawyer Magazine, 2000.

<sup>41</sup> Source: Accountancy Age Magazine, 2000.



**Figure 8**

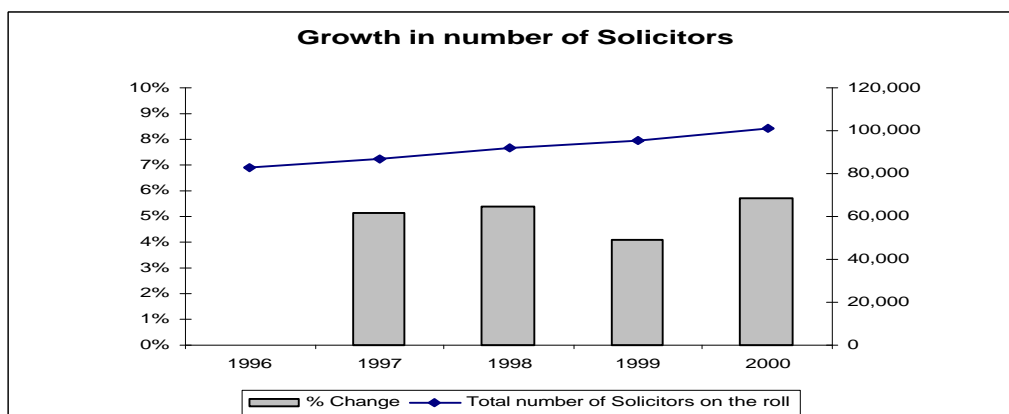


Source: The Lawyer

**Number of solicitors and earnings**

137. We have data on the total number of registered solicitors over the period 1996 to 2000, and the percentage changes year-on-year (see Figure 9). These data reveal steady growth in the profession over the last five years (averaging 5.5% per annum over the period), with the number of registered solicitors at 100,957 in 2000. The cumulative growth for the period from 1995 to 2000 was 21.9%<sup>42</sup>.

**Figure 9**

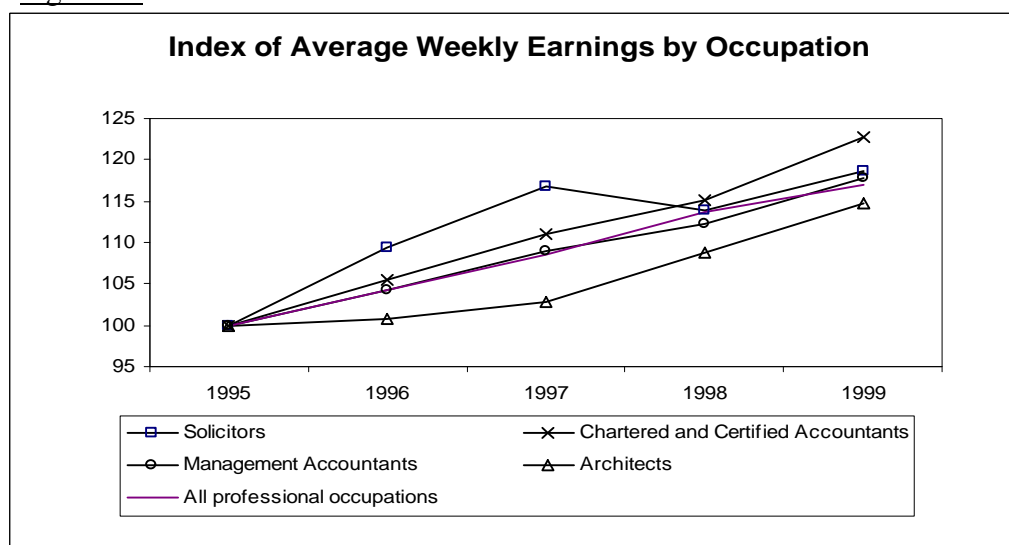


Source: Trends in the Solicitors Profession 1995-99

<sup>42</sup> Source: Trends in the Solicitors Profession 1995-99

138. New entry to the profession is represented here by the change in the number of registered trainee solicitors. There has been an increase from 3,058 in 1989 to 4,827 in 1999 expansion of 57.8%<sup>43</sup>. In the last two years average annual growth in the number of registered trainees has fallen from 16.6% (1997) to 1.8% (1998) to 0% (1999).
139. Solicitors' earnings have also experienced significant growth (see Figure 10), with the index of earnings growing from a base of 100 in 1995 to 118.6 in 1999<sup>44</sup> (compared with an index of 122.6 for chartered and certified accountants, 114.8 for architects, and 116.9 for all professional occupations).

Figure 10



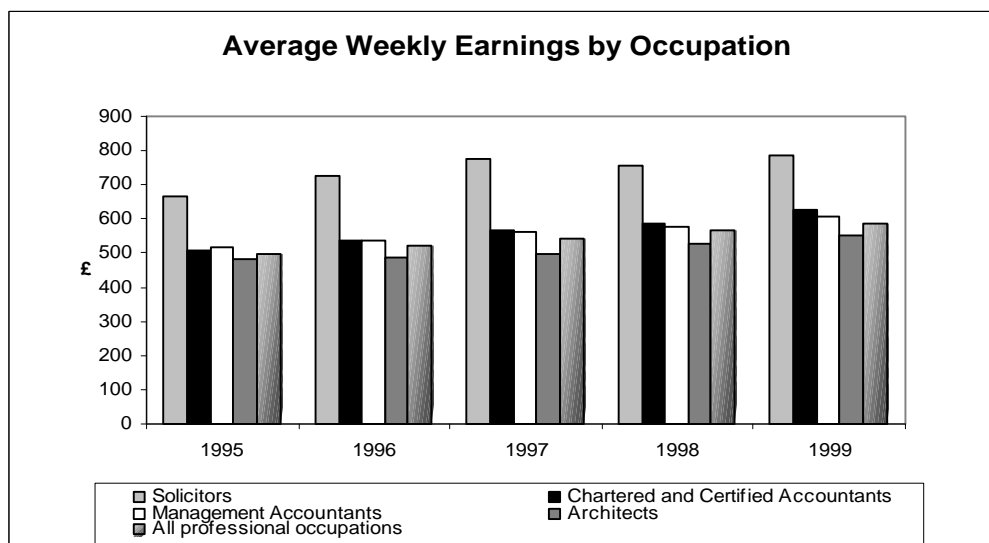
Source: The New Earnings Survey 1995-99

140. Figure 11 shows that in terms of average weekly earnings by occupation (in nominal terms), solicitors earn significantly more than both architects and accountants. In 1999 they earned, on average, £787.90 per week compared to £624.10 per week for chartered and certified accountants and £554.40 per week for architects.

<sup>43</sup> Source: Trends in the Solicitors Profession 1998-99

<sup>44</sup> Source: New Earnings Survey, 1995-99.

Figure 11



Source: New Earnings Survey 1995-99

### **Regulation of the solicitors' profession**

#### **The Law Society**

141. The Law Society was established by Royal Charter in 1831. It is the professional association and governing body of solicitors. It deals with complaints against solicitors and disciplinary matters, and issues practising certificates. Its powers and duties are derived from the Solicitors' Act 1974 (but see below for references to rights in the Courts and Legal Services Act 1990 (CLSA) and the Access to Justice Act 1999 (AJA) ).
142. The Law Society's governing body is the Council; most of the powers of the Law Society are exercisable by this body or by committees, sub-committees or by individual members of the Council appointed under s79 of the Solicitors' Act. The Council consists of 70 members elected by solicitors throughout the country. The reform proposals currently being discussed envisage expanding membership to 125.
143. The Law Society has custody of the Roll of Solicitors (a list of those admitted as solicitors) under s6 of the Solicitors' Act. Membership of the Law Society is voluntary but its jurisdiction extends to all solicitors, whether members or not. Non-practising solicitors are eligible for membership of the Society. Unless statute provides otherwise, no one may act as a solicitor unless he or she has been admitted to the Roll and possesses a valid practising certificate (see s1 of the Solicitors' Act).
144. Under the Solicitors' Act, the Society may, with the concurrence of the Lord Chancellor, Lord Chief Justice and Master of the Rolls, make regulations about the education and training of solicitors (s2). The Solicitors' Act was amended by

the Courts and Legal Services Act 1990 and the Access to Justice Act 1999 so that all training rules now need to be approved by the Lord Chancellor.

145. The Law Society – through its Council - is given the power to make rules (with the concurrence of the Master of the Rolls) for regulating, in respect of any matter, the professional practice, conduct and discipline of solicitors (s31). There are also 121 local law societies which have a role in shaping policy by reacting to proposals from headquarters which affect the profession as a whole.
146. The Law Society established a working party in 1999 to review the rules of professional conduct (contained in the Guide to the Professional Rules of Solicitors). The aim is to simplify the rules and make them less burdensome for the benefit of both clients and solicitors, without jeopardising necessary client protection.

#### **Council of Licensed Conveyancers**

147. The Administration of Justice Act 1985 created the Council of Licensed Conveyancers (CLC), responsible for controlling the admission, training, and professional standards and discipline of licensed conveyancers (licences were granted in 1987). The CLC's regulatory structure is based on that of the Law Society, with some minor differences. The CLC does not issue scale fees or provide any fee guidance. The CLC suggests in its submission that the restriction of its members to the provision of conveyancing services 'could change in the future' but it is not calling for this restriction to be removed.

#### **Institute of Legal Executives (ILEX)**

148. ILEX was formed in 1963 from the Solicitors' Managing Clerks Association. It is a company limited by guarantee and has a membership of over 22,000. ILEX provides legal education and continuous professional development for legal executives, but does not involve itself in the levels of fees levied by its members. Legal executives work either in solicitors' practices (where their fees are set by the supervising solicitor), or in private practice (where market forces prevail).
149. ILEX has been able to grant limited rights of audience in lower courts since 1998. Under the Access to Justice Act, it has also become authorised to grant rights to conduct litigation. Legal executives are prohibited from becoming partners or associate partners with solicitors, barristers or licensed conveyancers because of their respective professional codes. ILEX would welcome the introduction of multi-disciplinary partnerships (MDPs).

#### **Society of Scrivener Notaries**

150. Notaries are specialised legal officers who authenticate documents (so, for example, they can take effect abroad).
151. Two further legal professional bodies are the Institute of Trade Mark Attorneys and the Chartered Institute of Patent Agents. One of the issues raised by

respondents to the OFT's consultation paper concerned the Institute of Trade Mark Attorneys but, as explained in paragraph 227, this issue was not analysed. The Institute of Trade Mark Attorneys and the Chartered Institute of Patent Agents are not described further in this report. Professional bodies related to barristers and advocacy services are described in Chapter V.

### **Assessment of individual restrictions in the solicitors' profession**

#### **Direct entry restrictions**

##### *Entry qualifications*

152. Solicitors must undertake three stages of training: an academic stage, a vocational stage and a training contract. At the academic stage students must undertake a three-year undergraduate degree in law (subject to the usual funding arrangements in place for all undergraduate students). Alternatively, students undertake one year full-time study for the Common Professional Examination, following successful completion of their undergraduate degree in another subject (the CPE is usually self-financed). Mature applicants (over 25) may be admitted for the CPE if they have considerable experience (at least 10 years). Otherwise, they may be admitted if they have shown exceptional ability in an academic, professional, business or administrative field, sufficient standard of general education, good command of spoken and written English, and have satisfied the Law Society as to the suitability of their character.
  
153. The vocational stage (stage two) consists of the Legal Practice Course (LPC). There was a major overhaul of the LPC in 1993, with the aim of making the course more vocational than its predecessor, the Law Society Finals. The LPC is now offered by the College of Law and over 20 universities. As with the CPE, students must usually finance themselves. The accreditation and 'grading' of courses is undertaken by the Law Society's Legal Practice Course Board.
  
154. Finally, there is a two-year training contract (salaried) with a firm of solicitors. This final stage in a solicitor's training is analogous to an apprenticeship: during it the trainees must gain experience of the practice of law in three areas of their choosing under the supervision of a qualified solicitor of at least 5 years' standing. Trainees must also complete a Professional Skills Course during their training contract, covering topics which the Law Society considers are best studied once students have some work experience (advocacy and oral communication, financial awareness and business accounts, and ethics and client responsibilities). The Advisory Committee to the Lord Chancellor on Legal Education and Conduct (ACLEC) suggested a new qualification (Licentiate in Professional Legal Studies) to help those who could not get traineeships and pupillages, but this met with opposition from professional bodies and some legal education providers.
  
155. In addition to the training requirements described above, all solicitors in private practice must obtain a practising certificate (issued annually) from the Law

Society. In 1998 there were 95,521 solicitors on Roll of Solicitors of which 75,072 had practising certificates.

156. Numbers in the profession have been rising (see Figure 9 above). In our view, therefore, there is no obvious evidence of a major problem of unduly restricted entry. However, the number of training contracts has not always met demand from would-be trainees, and we learned that in the mid-1990s the Law Society discussed restricting entry. Law Society figures released earlier this year show that the supply of training contracts now exceeds the number of people passing the LPC (Legal Week 30/6/00). So long as decisions on the number of training contracts are taken independently by law firms, without influence from the Law Society, we do not see any cause for concern about entry to the profession.

### **Continuing Professional Development (CPD)**

157. Solicitors must undertake 48 hours CPD over each consecutive three-year period for the whole of their career. Newly qualified solicitors must undertake one hour of CPD for each month worked from the date of admission to 31<sup>st</sup> October following. In the first three-year period, solicitors must undertake 16 hours CPD in each year, including attendance at a specially approved management course.
158. Normally, at least 25% of the CPD requirement must be satisfied by participation in accredited courses provided by authorised trainers. The remaining 75% may be satisfied by attendance at non-accredited courses, research, writing articles and comparable activities.
159. Given the small number of hours involved, we do not believe that these requirements are unduly onerous.

### **Indirect entry restrictions: demarcation**

160. Certain areas of work are reserved to solicitors (and in some cases, to other lawyers) by statute. The general principle behind reserving work to solicitors is that regulation of the solicitors' profession affords client protection in circumstances where the costs of poor quality advice are very high for the client and/or third parties.
161. Statutory protection for clients includes the handling of clients' money; procedures for reviewing costs; legal professional privilege; Compensation Fund and professional indemnity; rules of conduct; investment business monitoring and disciplinary procedures. Moreover, the Solicitors' Act 1974 provides that unqualified persons cannot '*act as a solicitor, or as such issue any writ or process, or commence, prosecute or defend any action, suit or other proceedings*' (s20). This restriction prevents unqualified persons pretending to be a solicitor (s21).
162. The Solicitors' Act also prevents unqualified persons from preparing various types of legal document (s22). But there are exemptions, either in general terms

(for a barrister or a notary public) or in relation to specific areas of work (registered trademark agents and patent agents, for example, or licensed conveyancers). The Solicitors' Act also prevents non-solicitors from doing probate work (s23). It is also not possible to recover costs if an unqualified person is acting as a solicitor (s25).

163. However, reforms (such as the European Establishment of Lawyers Directive) which are aimed at facilitating the transfer of professionals between different branches of the legal profession (a form of supply-side substitution) will help undermine the demarcation of services and its impacts on competition<sup>45</sup>. For example, the AJA has made rights of audience portable across the two branches of the legal profession. Currently, a solicitor can transfer to the Bar after undertaking time in pupillage. These requirements have been relaxed and the time required in pupillage for a solicitor wishing to transfer to the Bar depends on his or her experience. Alternatively, a solicitor can switch to the Bar after obtaining rights of audience as a solicitor in higher courts. No pupillage is then required. The current training requirements for solicitors wishing to acquire these rights of audience are governed by the Higher Courts Qualification Regulations 2000 (in which took effect from 1st October 2000 and replaced the 1998 regulations). These new rules – by making it easier for solicitors to acquire rights of audience in higher courts – should facilitate the transfer of solicitors to the Bar.
164. The Higher Courts Qualification Regulations set out three main transfer routes: accreditation, development, and exemption on the basis of experience. Under the accreditation route, solicitors must be admitted for 3 years, apply for a certificate of eligibility and do an advocacy assessment (there is no interview or course requirement). Under the development route (or 'fast track'), solicitors take a course (and must pass) in procedure, evidence and ethics, and advocacy. They must also have a portfolio of advocacy experience signed off by a mentor. The development route will allow a solicitor to obtain higher rights of audience within six months of qualification as a solicitor and will become the only route to transfer in 2005, when the accreditation and exemption routes will be phased out.
165. The new Courts Qualification Regulations and the Access to Justice Act will also make it easier for former barristers to become solicitors with rights of audience. Under the new Regulations former barristers will be eligible for consideration by the Law Society if they can prove that they had higher rights of audience at the Bar and have recent advocacy experience. As from July 31<sup>st</sup> 2000, the Access to Justice Act has permitted barristers who transfer to another authorised body – for example, the Law Society - to retain rights of audience granted by the Bar Council.

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<sup>45</sup> When barristers switch to becoming a solicitor, they do not have to disbar themselves, but cannot hold themselves out to be barristers - they are subject to the Bar Council Code as 'non-practising barristers'. When solicitors switch to the Bar, they do not have to come off the Roll, but cannot have a practising certificate.

166. The Qualified Lawyers Transfer Regulations 1990 govern the requirements for barristers to become solicitors. These have not changed substantially since introduction, but may have to do so because of the EU Establishment Directive<sup>46</sup>. Under the 1990 regulations, barristers must pass a test in Professional Conduct and Accounts (a combined paper). In addition, they must *either* satisfactorily complete 12 months' pupillage and 12 months' legal practice acceptable to the Law Society (e.g. tenancy or squatting) *or* complete two years legal practice acceptable to the Society. Alternatively, and in addition to the test, barristers may qualify by having been employed in a way consistent with service under a training contract for a period not exceeding two years.
167. The Law Society received 184 qualified lawyer transfer applications from English and Welsh barristers during the first 10 months of 2000. According to Bar Council figures, about 70 solicitors apply each year to become barristers (Law Society Gazette 30 June 1999).
168. Despite this greater flexibility, facilitating supply-side substitution, the separate post-degree training for barristers and solicitors means that some vestiges of demarcation between the two branches of the profession are likely to remain (for instance because of the impact of third-party perception – see paragraphs 173 to 175 below). There has, however, been some discussion of a more radical reform: the introduction of a common training programme for both strands of the profession (see the First Report of the Advisory Committee to the Lord Chancellor on Legal Education and Conduct (ACLEC).
169. Our overall assessment is that the reservation of particular types of work to solicitors will tend to inhibit competition between solicitors and other lawyers or non-lawyers who may be equally capable of performing the services. Strict demarcation for most of these services has already been reduced, however, by recent reforms in the area (for example, the Access to Justice Act 1999). These reforms are discussed below under separate headings for each area of work affected. To the extent that the reforms are implemented (including reforms, discussed above, aimed at facilitating the transfer of professionals between the different branches of the legal profession) and allow consumers an informed choice between the services of a solicitor or some other professional, the impacts on competition should be reduced. The continued use of the titles “barrister” and “solicitor” in this scenario should not significantly inhibit competition within the legal profession.
170. Particular reforms aimed at reducing the demarcation between solicitors and other lawyers/non-lawyers are discussed further below.

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<sup>46</sup> Implemented May 22 2000. Lawyers from EU countries do not have to take a test if (broadly speaking) they have practised for 3 years in another jurisdiction. This has implications for (amongst others) barristers from England and Wales because it would be anomalous if they had to take a test and EU lawyers did not. The Law Society is carrying out a major review of the implications.



*Advocacy*

171. From 1993, under the Courts and Legal Services Act 1990 (CLSA), the Law Society was able to grant rights of audience in certain higher courts to solicitors in private practice. From 1997, the Law Society could grant limited rights of audience to employed solicitors. Progress under the CLSA reforms was slow, however. Only limited numbers of solicitors obtained full rights of audience.
172. Under the Access to Justice Act 1999 (AJA), all solicitors are now qualified to appear in any court, subject to extra training requirements laid down by the Law Society (the Higher Courts Qualification Regulations 2000, described above). This should make it easier to obtain full rights - within six months of qualification for newly qualified solicitors. It is too early to gauge whether the AJA reforms will increase competition in advocacy, but it will be important to monitor the number of solicitor-advocates. The latest figures show that there are about 1,000.
173. One existing impediment to the full impact of AJA reforms being felt is third party perception – and in particular the attitude of some judges to solicitor-advocates. Our data suggest that solicitors remain largely excluded from positions in the Higher Judiciary. A recent Law Society report (*Broadening the Bench*, Law Society, data current as at 1 June 2000) shows that of the 154 permanent judiciary of High Court rank or above, only one is a former solicitor (0.6%) with one more to be appointed in October 2000. Of the 547 Circuit Judges, 74 are former solicitors (14%). Finally, out of the 1,352 Recorders, 153 are former solicitors (11%).
174. Further evidence of the dominance of barristers in the Higher Judiciary is provided by data on the appointments made by the current Lord Chancellor between his coming into office in May 1997 and November 1999. Of the 4 appointments to the House of Lords, 11 to the Court of Appeal and 19 to the High Court Bench, none was a solicitor. 71 appointments were made to the Circuit Bench, of whom 4 were solicitors. Moreover, in the 1998/9 round of recruitment, none of the 7 judges appointed to the High Court were solicitors. Only one out of the 15 Circuit Judges appointed, and 10 out of the 136 Assistant Recorders appointed were solicitors (Judicial Appointments annual report, 1998/9).
175. The Law Society claims that the system for appointing judges is biased against solicitors – an allegation that the LCD denies. A Law Society report (*Broadening the Bench*, 2000, already mentioned above) identifies some of the barriers to a more representative judiciary. These include the practice of informal consultations, entry criteria which disadvantage or bar solicitors, and requirements to undertake part-time service which are more appropriate to barristers (as self-employed people) than to partners in a firm. The report calls for a Judicial Appointments Commission. The Law Society has now withdrawn from the consultation process for judicial appointments, a step severely criticised by the Lord Chancellor (LCD press release, 385/00, 31 Oct 2000).

176. The Solicitors' Association of Higher Court Advocates is also concerned about the lack of a level playing field, and suggests that barristers get full rights of audience too early in their career (after only six months of pupillage). Solicitors, on the other hand, have to complete their two-year training contract plus a further six months training. This diversity of requirement may suggest that a common training programme for all lawyers (as in some commonwealth legal professions) is needed to address the demarcation issue fully.
177. The competition issue in the provision of advocacy services was identified many years ago, and considerable reform effort has already been made. However, third-party perceptions may be limiting the number of solicitor-advocates competing in this market. Numbers of solicitor-advocates should be monitored following the recent AJA 1999 reforms in this area.

*Litigation*

178. Litigation is defined as the right to issue proceedings before any court and to perform any ancillary functions in relation to proceedings. The Courts and Legal Services Act established a procedure to give bodies authorised status to grant rights to conduct litigation and advocacy. The Law Society, as an authorised body under the CLSA, accordingly grants rights to solicitors to conduct litigation. This procedure has since been amended by the AJA so as to extend these rights to ILEX and to the Bar Council. However, it is a matter for the LCD (after consultation) to decide which bodies can grant rights to conduct litigation or advocacy. It is then up to the body itself to decide whether to make use of these rights.
179. The Bar's decision to extend litigation rights only to employed barristers could serve to limit competition in the litigation service market (see Chapter V). However, as with the reforms to advocacy rights, it is too early to assess the impact of the AJA reforms (for example, the extent of take-up of these rights by employed barristers is unclear). Even if the right to conduct litigation is extended to independent barristers, one restriction currently in place that will inhibit the take-up of this right is the rule that only solicitors and certain other professionals can instruct barristers directly.
180. LCD would like to encourage other professional bodies to become authorised under the CLSA to grant rights to conduct litigation services. ILEX states that it would like to see CLSA used to open up the legal services market further. However, they claim that legislation, especially the Solicitors' Act, is a barrier to greater integration. Two particular restrictions are that ILEX members cannot prepare probate papers except under supervision of a solicitor (s23 of the Solicitors' Act), and members not employed by solicitors cannot instruct barristers.

181. There are thus a number of restrictions affecting the market for litigation services, which have the effect of reducing the number of competing players. These are discussed more fully in the chapter focusing on barristers (Chapter V).

*Unqualified legal advisers*

182. A further demarcation issue is the new entry of unqualified legal advisers (claims assessors) into the field of personal injury claims. The Blackwell report investigated the situation and decided that there were no grounds at present for regulating these new competitors to solicitors. The report recommended consideration of a number of options including non-statutory regulation, e.g. the insurance industry would not pay out on claims to practitioners who did not have indemnity insurance or belong to an approved body.

*Conveyancing*

183. Conveyancing is reserved to solicitors (under the Solicitors' Act s22) and, since the Administration of Justice Act 1985, to licensed conveyancers (to whom the first licences were issued in 1987). However, licensed conveyancers, of whom there are no more than about 400, have only a small percentage of the market whilst according to the Law Society (Jenkins, 1999) solicitors have a market share of at least 95%.
184. The Law Society claims that because of the liberalisation of advertising restrictions (see below), the market for solicitors' services has become more competitive and fees have come down in real terms. Our evidence, however, suggests that competition in the market for conveyancing services remains inhibited (the wide variance in conveyancing fees charged is noted in the fee guidance section below). The CLSA (ss 34-52) provided for further competition to be introduced by means of an exemption from s 22 of the Solicitors' Act for 'authorised practitioners'. It was intended that these should be, for example, banks and building societies employing legally qualified staff. The scheme has, however, never been implemented and we believe that this has contributed to the apparent lack of competition in the conveyancing market.

*Probate*

185. The Solicitors' Act (s23) restricts the application for probate to solicitors. In effect, other potential service providers - such as accountants - can supply probate services when named as executor, but not as an agent of the executor.
186. The CLSA (s54) provides for the right to perform probate work to be extended to other potential competitors such as banks, building societies and insurance companies. However, this scheme has not been brought into force. The ICAEW claims that this prevents accountants from competing, but the LCD says there is no demand for implementation from potential suppliers. Our evidence (see the section on fee guidance below) suggests that competition in the market for probate services is restricted and we believe that the failure to fully implement the CLSA (s54) may have been a contributory factor.

*Tax*

187. Solicitors and barristers also have reserved work in some tax matters: the drafting of legal documents (s22 and 23 of the Solicitors' Act) and rights of audience before the General and Special (tax) Commissioners. This restriction also has a statutory origin. The Chartered Institute of Taxation and Association of Taxation Technicians raised this issue but we found no further information about the impact of this restriction.
188. Accountancy professionals suggested to us that legal professional privilege gave an advantage to solicitors over other tax advisers such as accountants. Solicitors and barristers have a duty, and therefore a right, to keep client matters confidential, and this legal professional privilege protects communications between solicitor and client from being disclosed, even in a court of law. Communications between other professionals and their clients are not privileged. This may lead clients who are seeking tax advice to prefer solicitors to other, equally qualified, professionals.
189. The duty of confidentiality to the client and the legal professional privilege that results from it are recognised in English law. These same rights are also protected under European Human Rights legislation. This suggests that it would be necessary, if any action were taken to level the playing field, to extend these rights to clients of other equally well qualified professionals. Arthur Andersen noted in their submission that the US has extended privilege to approved tax advisers. It suggests applying privilege to classes of work, rather than to the service provider.
190. The Law Society suggested that, if privilege were to be applied to other professionals, it would be necessary to ensure that they received similar training and were bound by similar ethical codes. We do not disagree, but think it possible that only limited additions would be needed to other professions' training and codes of ethics. We believe that the current rules restrict and distort competition.

**Indirect entry restrictions: employed solicitors**

191. Solicitors employed by non-solicitors cannot act for third parties when they are acting 'as solicitors'. Solicitors employed by legal expense insurers, for instance, act for a client if the value of the case is over the 'no costs' claims limit (currently £5,000). For example, if a motorist sued a garage which had carried out faulty repairs, and claimed on his motor insurance for the legal cost involved, the insurer might want to represent him in court, rather than pay a solicitors' firm to do so. This restriction may have the effect of limiting potential competition from organisations other than solicitors' firms - such as legal expense insurers - which could compete in the provision of certain services.
192. The origin of this restriction is Solicitors' Practice Rule 4. This rule limits employed solicitors to the provision of solicitor-type services (including legal

advice and reserved work such as litigation, advocacy, conveyancing and probate) to the employer itself. (There are also some limited exceptions set out in the Employed Solicitors' Code 1990). The Law Society justifies this restriction on the grounds of client protection. The quality of reserved work depends on the full regulation of the provider: the Law Society provides this regulation for solicitors in private practice, but there is no similar comprehensive regulation of employed solicitors.

193. It was the RAC (a motoring organisation) rather than the Association of British Insurers (which represents legal expenses insurers) that raised this restriction as a potential problem for competition, in addition to other rules preventing companies from establishing a solicitor practice. In practice, legal expense insurers are able to circumvent this restriction to a certain degree by, for example, negotiating favourable terms from solicitors in private practice for block contracts of work.
194. Nevertheless, in our view, this restriction is reducing the number of potential competitors in certain markets. With respect to legal expense claims, attempts to circumvent the rules are evidence of a degree of potential competition for the provision of these services. Moreover, the regulatory issue over quality of service could be dealt with in other, less intrusive, ways (e.g. using regulations applicable to the individual lawyer rather than the business structure in which they work).

**Indirect entry restrictions: multi-disciplinary partnerships**

195. There is no longer a statutory ban on multi-disciplinary partnerships (MDPs) since the Solicitors' Act prohibition was repealed by the Courts and Legal Services Act 1990 (section 66(1)). The CLSA left it up to the professional bodies whether to make rules prohibiting MDPs. To date, MDPs (e.g. a firm with both accountants and solicitors as partners) remain prohibited - primarily as the result of Solicitors' Practice Rule 7 (and to a lesser extent Rules 4 and 5). This restriction could inhibit new entrants to the market for legal (and other) services, prevent cost efficiencies arising from economies of scale and scope and increase clients' search and transaction costs. Chapter VI discusses this issue from the perspective of the accountancy profession.
196. Practice Rule 7 is justified on the grounds that it protects the independence of solicitors. It states that:
- Solicitors cannot share professional fees with any person except a practising solicitor, practising foreign lawyer, employee or retired partner or predecessor of the solicitor.
  - Solicitors cannot enter partnership with any person other than a solicitor or registered foreign lawyer or a recognised body.
  - Solicitors cannot share ownership of an incorporated practice with non-lawyers.

197. Rule 7 is reinforced by Rules 4 (see above) and 5. Solicitors' Practice Rule 5 provides that solicitors must comply with the Solicitors' Separate Business Code in controlling, actively participating in or operating a business which:
- Provides any service which may properly be provided by a solicitors' practice; and,
  - Is not itself a solicitor's practice or a multi-national partnership.
198. The Solicitors' Separate Business Code prohibits a solicitor from providing certain legal services other than as a solicitor and requires certain safeguards where there is a connection between a solicitor's practice and his or her separate business. According to the Law Society, the aim of this restriction is to ensure that the public knows whether a service is provided by a solicitor acting as such and therefore within Law Society regulation - or outside the scope of a solicitor's practice and regulation.
199. The solicitors' profession is divided in its view on MDPs. Those opposed claim that the legal profession would lose its independence, which would not be in the public interest. It is also claimed that MDPs could give rise to increased conflicts of interest and conflicts of duties (e.g. in terms of confidentiality and legal professional privilege). According to opponents of MDPs, the regulation of non-solicitor members could also prove difficult.
200. The arguments in favour of MDPs include providing a "one-stop shop" for clients that require a range of specialists but only want to hire a single firm; allowing firms with established reputations in one profession to offer services in another; allowing solicitors to compete with other professions who already provide 'one-stop shopping'; and the lack of adverse consequences in jurisdictions where they have been allowed. It is also argued that solutions can be developed to address specific regulatory issues such as independence and conflicts of interest without the need to ban MDPs (See: *MDPs, Why? Why not?* Law Society, 1998).
201. The Law Society carried out consultations in 1987, 1993 and 1998 on the MDP issue. In the most recent consultation, the response rate was low but most respondents favoured relaxing the rules. The Law Society Council decided that its long-term aim was to allow solicitors to provide legal services in the widest range of organisations, subject to client protection provisions. It asked its MDP Working Party to prepare interim solutions that would allow some deregulation in the short term. The Law Society is about to go out to consultation on a version of MDPs where a majority of partners would be solicitors.
202. Our evidence suggests that there is demand amongst some sections of the profession to be allowed to form MDPs. Examples of possible partnership combinations cited are in the field of property services (e.g. surveyors, estate agents, and solicitors); financial services (e.g. accountants, independent financial advisers, solicitors) and family law (e.g. solicitors and mediators). Two City law

firms interviewed said that their clients wanted integrated services extending beyond those traditionally provided by solicitors.

203. There has also been considerable debate in international lawyers' forums and within professional bodies in other countries on the issue. Although MDPs are permitted in some jurisdictions, an international consensus has yet to emerge. Overall, the Law Society of England and Wales is probably more pro-MDP than many other legal professional bodies. Some foreign legal professional bodies (notably in Australia) have been applying themselves to developing models that address the potential risks in MDPs such as differing professional standards and conflict issues.
204. In our assessment, the current restrictions on the formation of MDPs are inhibiting competition, potential cost efficiencies, and customer choice and convenience. However, any reform would need to address Rules 4, 5 and 7 simultaneously – and there could be a risk that a small number of large accountancy firms could come to dominate the market for legal services (although competition law – if extended in full to the professions - should address this issue).

**Conduct restrictions: advertising**

205. Solicitors may advertise providing they comply with the Solicitors' Publicity Code 1990 (SPR). Detailed restrictions, over and above the requirements of all advertising relating to truthfulness and accuracy, include:
- Advertisements may name clients (with written consent) but cannot refer to success rates or prejudice clients' interests.
  - Solicitors can advertise their own fees but statements must be clearly expressed and state the circumstances in which charges may be increased.
  - Advertisements cannot make direct comparisons with or criticism of the fees or quality of service of another solicitor.
  - Solicitors may not publicise by means of unsolicited visits or phone calls (with some limited exceptions, e.g. to current or former clients).
206. We do not think it likely that these restrictions have a significant effect on competition for the business of large clients. Large clients do not usually pay much heed to advertising but rely on reputation, previous work carried out by the firm and personal relationships.
207. These restrictions on advertising could, however, be restricting competition for the business of individuals and small businesses. An individual requiring conveyancing services or advice on a will is likely to be more cost-conscious and less sensitive to reputational factors. Advertising could well be an effective competitive weapon in this segment and an advertisement that a particular firm charges (say) 20% less than its rivals might be a good commercial strategy.

Equally, cold-calling is more likely to be effective where the potential client (e.g. a small business starting up) is unsure where to go to find legal support.

208. Additional support for the removal of the remaining restrictions on advertising is provided by empirical research (see Chapter II) which strongly supports the removal of all unnecessary restrictions, and is reinforced by pressure within the solicitors' profession for liberalisation. The Law Society's Regulation Review Working Party (RRWP), for example, is already considering proposals to reduce advertising restrictions in the Code, including restrictions on price/quality comparisons and cold calling. Part of the impetus for this reform comes from a desire to level the playing field with other providers of legal services (e.g. the Bar Code of Conduct does not prevent cold calling by barristers' clerks to solicitors; and unqualified and unregulated advisors are also able to cold call). Any changes to the Code would, however, first require consultation with members. The Law Society told us that they would need to take account of concerns that cold-calling would be undesirable in some areas (personal injury, for example).
209. The Regulatory Review Working Party (RRWP) is also considering reform of the current restrictions on payment for referrals in the light of the Blackwell report. RRWP's preliminary view is that the current restrictions are over-restrictive and difficult to enforce, and should be replaced with a disclosure requirement. The Law Society told us that lifting the ban on referral fees was one option, though more limited reforms were also under consideration.
210. We believe that these restrictions are hampering both the development of an on-line market-place (for example, payment to an intermediary firm that 'introduces' clients and suppliers over the internet) and the ability of solicitors to compete with non-legally qualified practitioners.

**Conduct restrictions: fees**

211. Lawyers differ from other professions in that, in certain circumstances, it is not the lawyer's own client who pays legal fees but the other party to a dispute. Accordingly, there are controls both on how solicitors charge fees to their own clients and to the other party. There is also a broad distinction between contentious and non-contentious work. Non-contentious work is work not involving the courts, such as conveyancing, company acquisitions and mergers, administration of estates and trusts outside the court, preparation of wills and contracts, and proceedings before most tribunals. Contentious work is work in relation to court cases, where action has been started in the court.
212. Fees for legal work funded by the Community Legal Services Fund (formerly legal aid) are also controlled. We have not investigated this system.

*Non-contentious work*

213. The Law Society issues guidance on how to calculate the value element in non-contentious work, based on a percentage of the value of the property or money



concerned. There are a number of fee scales covering probate, domestic conveyancing, other non-contentious work and charges when acting on behalf of a mortgage lender.

214. This fee guidance derives indirectly from the consumer protection measures contained in the Solicitors' (Non-Contentious Business) Remuneration Order 1995. It states that fees must be 'fair and reasonable'; sets out what a solicitor may consider when setting fees, including the value of the money/property involved; and gives the client the right to apply for a Remuneration Certificate from the Law Society. The Law Society will find a bill 'fair and reasonable' when the guidelines have been followed, as they are based on case law from judges' decisions about what is 'fair and reasonable'. This case law exists because, under the Solicitors' Act, the client can also apply for assessment of the bill by the courts.
215. There is little doubt that *mandatory* fee scales can distort or even eliminate price competition. However, even fee guidance can restrict competition because their circulation among the suppliers in a market may provide a lead on prices, which firms will tend to follow, irrespective of their own costs. In this way, fee guidance encourages tacit collusion<sup>47</sup>. The effect on competition will depend on the level of the fee guidelines relative to the prices determined by competitive market forces.
216. In defence of fee guidance, the Law Society stresses its voluntary nature and the fact that solicitors have to request it from the Law Society. Moreover, the case law on which the guidelines rest would continue to exist (given the client's right under the Solicitors' Act to apply for an assessment of a bill by the courts) even if the guidance disappeared (although solicitors would have to look it up in reference works). They also claim that there has been a shift away from checking whether prices are fair and reasonable. Now the onus is on solicitors to provide advanced costs information (and the Law Society will check whether this has been done in the event of a complaint).
217. The Law Society also claims that, in practice, the guidelines are not much used in conveyancing (although they may continue to be used in some localised markets). Instead, solicitors generally charge on a fixed price basis. There is evidence that conveyancing fees have indeed dropped over the last decade (though not as fast as estate agents fees: Jenkins, 1999). Other evidence does not, however, suggest the existence of a highly competitive conveyancing market. A Consumers' Association price survey (Which?, October 1995) found conveyancing prices for a freehold house worth £75,000 varied between £117 and £750 in England. A

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<sup>47</sup> This approach is apparent in a number of decisions of the European Commission and Court of Justice, e.g. Case 45/85 *Verband der Sachversicherer e.V. v Commission* and IV/34.983-FENEX. It is also to be seen in the MMC report on Private Medical Insurance and in the decision of the French Conseil de La Concurrence in respect of architects.

greater degree of price convergence would be expected in the presence of strong competition and price transparency.

218. The Law Society says guidelines are more prevalent in probate because of the difficulty of determining fees when administering an estate. A report of the Law Society's Probate Section Conference said that: *there were many at the workshop who still use the guidance issued by the Law Society...in some cases, the application of the guidelines meant that the bill simply looked too high.. Although it was generally agreed that application of the Law Society's guidelines would ensure success on an application for a remuneration certificate, it would not necessarily assist in the long game of keeping clients.* (Conference Special, August 2000).
219. Once again, our evidence on the variance in fees charged suggests that competition is not strong in this market. A Consumers' Association survey of 30 solicitors (*Which?*, November 1998) found hourly rates ranged between £51 and £135, and the total cost of administering an estate varied between £400 and £2,000 (including Scotland). This survey also indicated that there were a variety of different charging methods in use, and that some solicitors were reluctant to 'unbundle' services and just provide the application for probate. Ten of the largest banks were also surveyed by the Consumers' Association and it was found that their charges were based on a percentage of the value of estate and were higher than those of solicitors. Banks also tended to levy extra charges and set minimum fees. Furthermore, five banks insisted that they should be appointed as executor as a condition of administering the estate.
220. Perhaps as a result of the apparent lack of price competition in the probate market, "do-it-yourself" probate applications have increased: from 21% to 30% of all applications between 1991 and 1997 (Jenkins, 1999).
221. Overall, our evidence suggests that the Law Society's current fee guidance may be inhibiting price competition for non-contentious services, particularly probate work (see also the discussion of the role of the CLSA reforms of the probate and conveyancing markets at paragraphs 183 to 186). Fee guidance appears to be used less in relation to conveyancing services, although competition in this market also appears to be limited.

#### *Contentious work*

222. Charges for contentious work are usually levied on the loser after the case has been concluded. These charges can be challenged by the opposing side and the solicitor's own client – although the latter is very uncommon. The assessment of charges (formerly known as "taxation") is carried out by court officials and judges (formerly known as taxation masters). There are two procedures, summary assessment (the court that has heard the case assesses the costs) and detailed assessment (the assessment is made later).

223. As part of this assessment, the court has to take into account certain factors. The Senior Costs Judge issues guidelines specifying inclusive hourly rates for three different grades of fee earner in over 40 localities in England and Wales (although this does not cover barrister’s fees). These guidelines are drawn up in consultation between a designated civil judge, local solicitors and barristers, court user groups and district judges in each area. They are not mandatory but are described as an aid for judges. Guidelines can also act as a benchmark when parties are negotiating costs. The rules for the recovery of costs are set out in the Civil Procedure Rules (recently revised as part of the Woolf reforms) and solicitors’ own clients have the right to ask for their costs to be assessed under the Solicitors’ Act (s70).
224. This system of charging could be justified by reference to its role as a mechanism to protect the fee payer (whether the solicitor’s own client, or the other party) against excessive charging. There is a danger that costs will be higher than in a system where each side always pays its own costs: the probability of extra expenditure being borne by the party incurring it is lower in a system where the loser pays both sides’ costs. On the other hand, the procedure could clearly displace any potential fee competition with a focal point for tacit collusion at the guidelines’ “acceptable” rate. Indeed, the specialist costs draftsmen who in practice draw up a solicitor’s bill are familiar with what is acceptable for different types of case.
225. An alternative form of charging has emerged for some contentious work, for example, for fast track trials (claims valued at up to £15,000). In these cases lawyers’ costs are fixed in accordance with one of the aims of the Woolf reforms. By making fees more transparent before a service is purchased, this type of charging may increase competition, help bring costs down and provide more certainty for clients (although we have no evidence to show that this has indeed been the case). The Law Society sounds a cautious note, however, by pointing out that this system also *‘has the potential of imposing a de facto mandatory scale’*.
226. We believe that assessment of charges by the Courts is inevitable for contentious work. The impact on competition could be reduced by (a) discontinuing assessment for non-contentious work and (b) being vigilant to ensure that fee rates for contentious work are not promulgated outside that context.

### **Further restrictions**

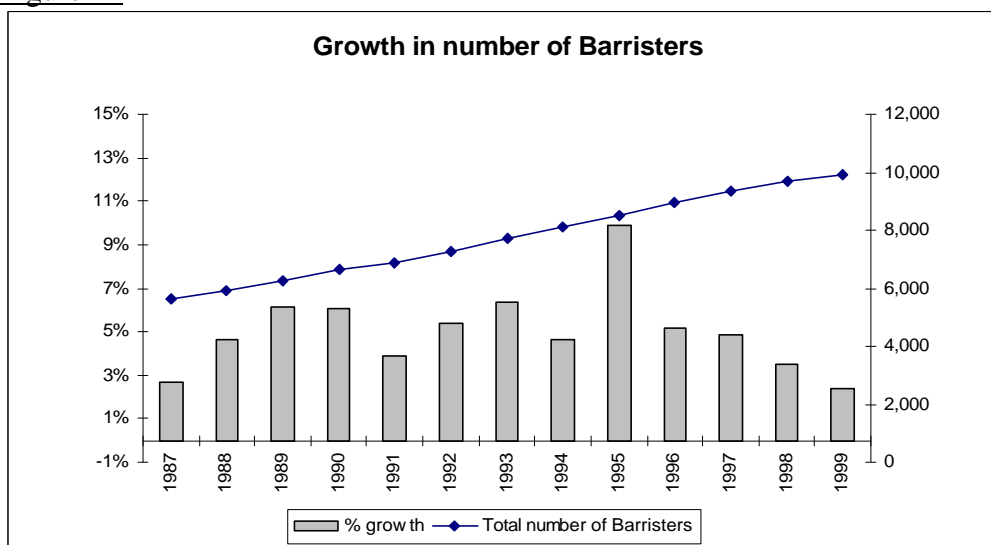
227. Several other issues were raised in the responses to the consultation. After an initial assessment, it was decided that their impact on competition appeared insufficient to warrant further investigation within the scope of this report. These issues are listed at Annex F.

## V Restrictions in the legal profession: barristers

### Economic characteristics

228. We have been able to find only very limited data on barristers. The data we have are restricted mainly to numbers of barristers (juniors and seniors) active in the profession. We have not been able to find reliable data on fees, profits or earnings.

Figure 12



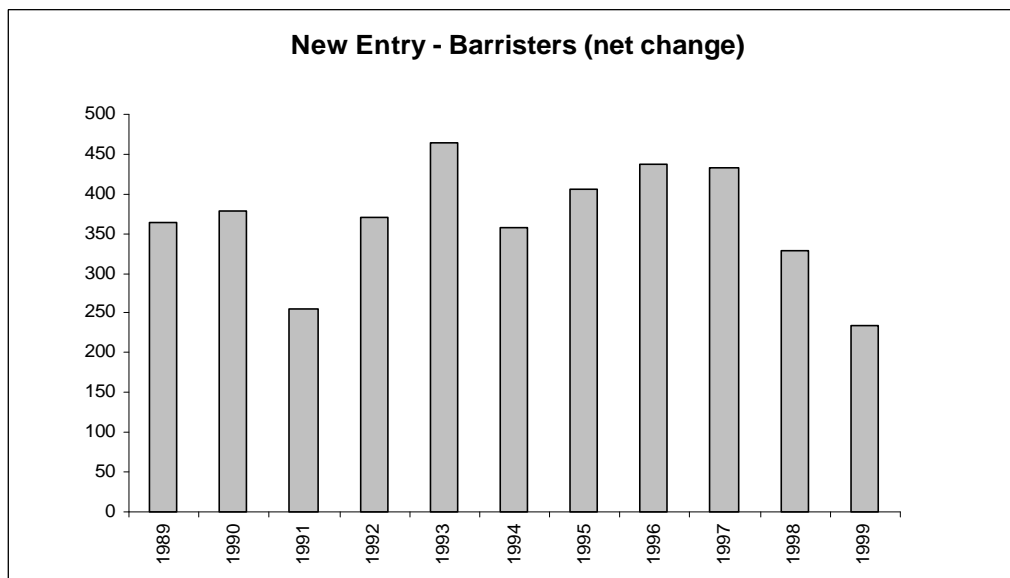
Source: Report on the survey of Barristers Chambers 1999 and 2000, BDO Stoy Hayward.

229. The total number of barristers has grown at a fairly steady rate for more than a decade: from 5,642 in 1987 to 9,932 in 1999. After a peak growth rate of 9.9%<sup>48</sup> in 1995 (see Figure 12), the year-on-year increase in the number of barristers has slowed down markedly to an annual increase of just over 2% in 1999. Cumulative growth from 1995-1999 was 22.7%<sup>49</sup>. From the data we did receive, we are able to reach conclusions on the entry of new barristers (see Figure 13).

<sup>48</sup> Source: BDO Stoy Hayward.

<sup>49</sup> Source: BDO Stoy Hayward.

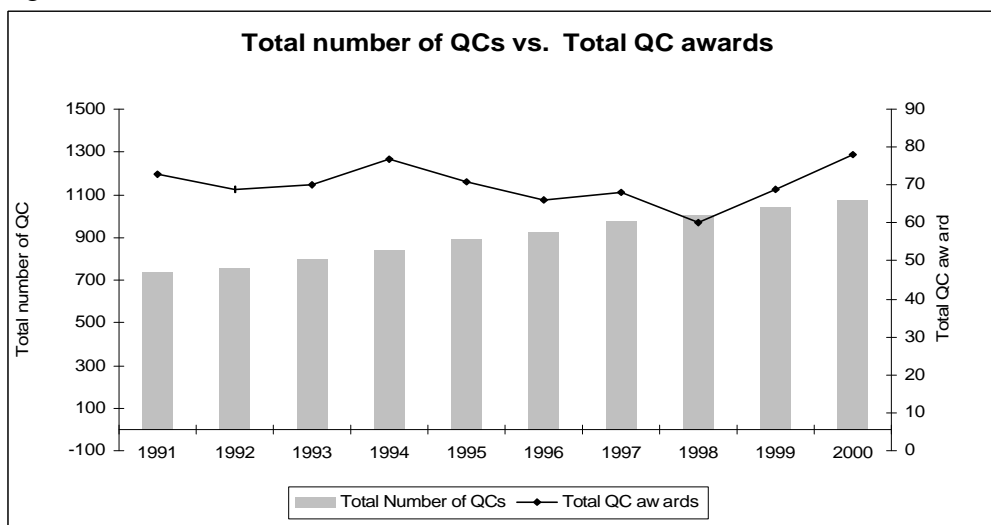
Figure 13



Source: Report on the survey of Barristers Chambers 1999 and 2000, BDO Stoy Hayward.

230. However, we can only assess the net change from year to year (rather than trends in new entry, which may not be identical). The rate of net increase in numbers of barristers has been diminishing since 1997. This slowdown may be due to a number of factors, among which are the increased costs of qualifying to enter the profession and the impact of the government's recent reform programme. Thus it is possible that a combination of the Woolf reforms promoting settlement of litigation at an early stage, government promotion of alternative dispute resolution (ADR) and the extension of rights of audience to solicitors, have together reduced the demand for advocacy services in litigation. Solicitors may be less likely to use barristers, following the emergence of solicitor-advocates, and because solicitors are tending to do traditional barrister work in-house (such as drafting pleadings).
231. A report by the Goldsmith Working Party on Financing Entry to the Bar (July 1998) illustrated the recent increase in the costs of qualifying. In 1990-91 over 60% of students taking the Bar Vocational Course (BVC) received some kind of local authority grant, and over 50% received a full grant. By 1996-97, however, only 6% of BVC students received a grant, fewer than 3% received a full grant.
232. Figure 14 shows the total number of Queen's Counsel (QCs) and the number of new QC appointments over time. As with barristers as a whole, the number of QCs has increased steadily in the last decade – from a total of 736 in 1991 to 1,072 in 2000. The average annual rate of growth in the number of QCs was 4.3% from 1991 to 2000.

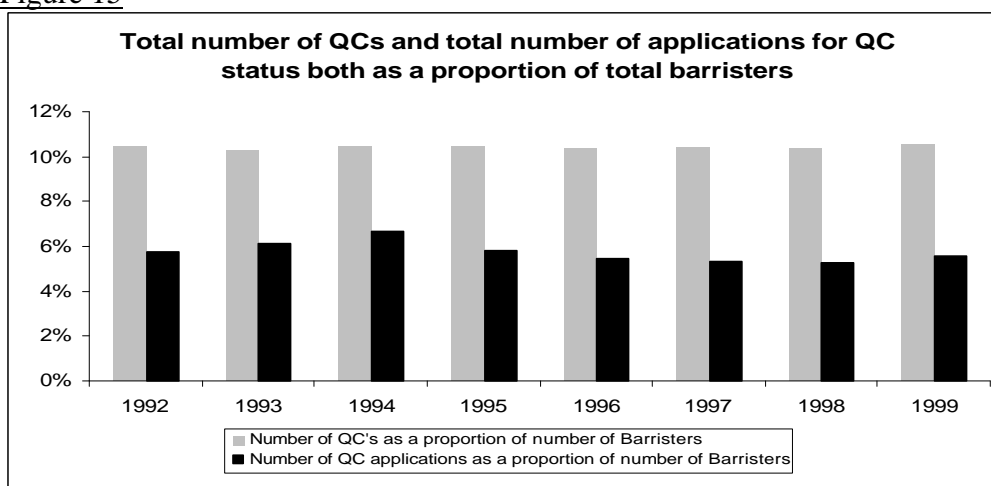
Figure 14



Source: The Lord Chancellors Department and Parliamentary Questions, Andrew Dismore MP.

233. The level of appointments has remained fairly constant over the period, varying between a low of 60 new QCs in 1998 and a high of 78 in 2000, compared with an average of 70 per annum over the period. The total number of QCs has steadily increased, suggesting that the rate of exit (e.g. by retirement) amongst QCs has been lower than the rate of new appointments. Figure 15 illustrates how the number of QCs as a proportion of all barristers has remained fairly constant – varying by only 0.1% around an average of 10.4% over the period 1992 to 1999. Figure 15 also illustrates how applications for QC status have remained reasonably stable over the period as a proportion of the total number of barristers. On average the rate of application over the period was 5.75%. Applications have kept up with growth in barrister numbers, but appointments have not.

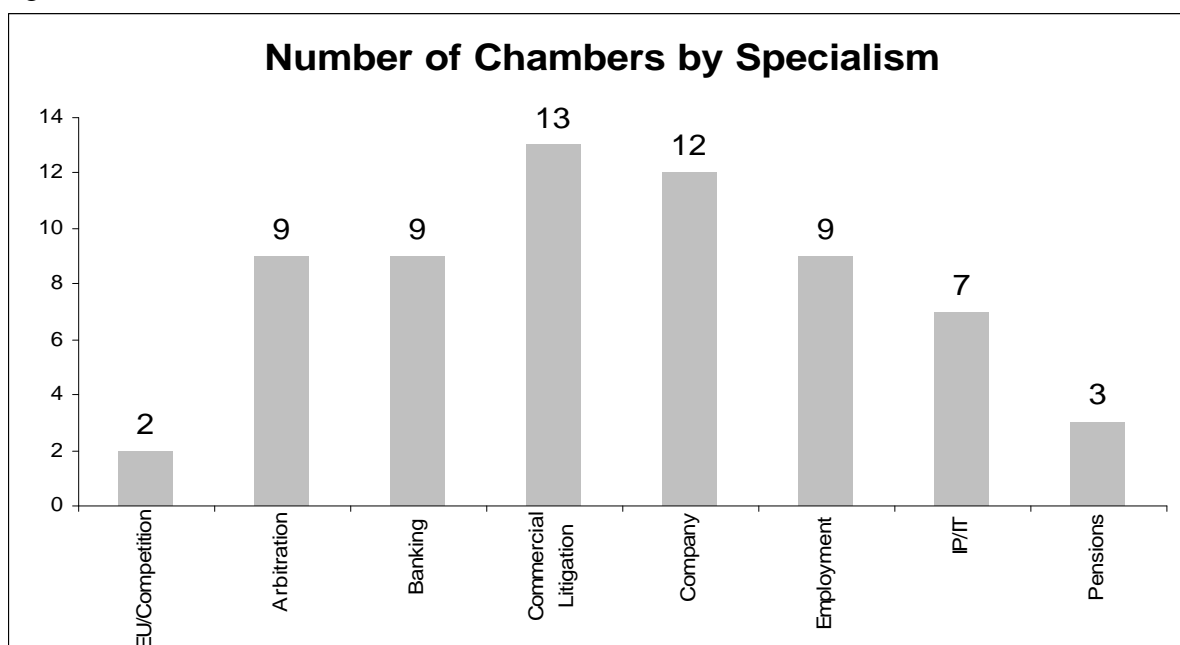
Figure 15



Source: The Lord Chancellors Department and Parliamentary Questions, Andrew Dismore MP.

234. In addition to data on the size of the profession measured as numbers of barristers, we have data providing an indication of the relative level of concentration in the provision of barristers' services (see Figure 16). Barristers belong to Chambers and it is the clerks of Chambers who normally negotiate on behalf of individual barristers. In practice, our observation is that competition takes place at the level of Chambers rather than at the level of individual barristers. As regards the number of Chambers defined by specialist area, our data show that for certain services, there are very few Chambers competing. For example, in EU and Competition Law, there are currently only two specialist Chambers,<sup>50</sup> [details omitted]. By contrast, Commercial Litigation is the least concentrated area, with 13 specialist Chambers. We believe that mergers between Chambers are likely in the face of increasing competition from solicitor-advocates.

Figure 16



Source: www.chambersandpartners.com

### **Regulation of the barristers' profession**

#### **The General Council of the Bar and the Council of the Four Inns of Court**

235. The Bar is regulated by the General Council of the Bar in conjunction with the Council of the Four Inns of Court (COIC). COIC is responsible (subject to policy direction from the Bar Council) for regulations governing Call to the Bar and administers disciplinary tribunals related to the more serious complaints. The Bar Council is responsible for regulatory matters including:

- Content of the Bar Vocational Course;
- Pupillage;

<sup>50</sup> Source: www.chambersandpartners.com

- Continuing Professional Development;
  - Code of Conduct; and,
  - Investigating and prosecuting complaints of professional misconduct against barristers.
236. The full Bar Council meets on average 8 times per year. It debates and decides major issues of policy. The detailed work of the Bar Council is carried out by committees. The General Management Committee is the senior overarching committee of the Bar and is responsible for directing day to day management of business. The composition of the Bar Council was reviewed by a working party chaired by Lord Alexander of Weedon QC. Its recommendation was to increase the representation of employed barristers on the Council.
237. Additional bodies with a representative role in the legal profession – but currently no regulatory functions – include the Institute of Licensed Advocates (ILA) and the Bar Association for Commerce, Finance & Industry (BACFI). The former is developing a new legal qualification which would allow Bar Vocational Course (BVC) graduates (see below) to supply legal services, including advocacy services, to the public, subject to complying with specified training and licensing requirements. They will shortly be submitting an application to the Lord Chancellors’ Department (LCD) for authorised body status.

### **Assessment of individual restrictions in the barristers’ profession**

#### **Direct entry restrictions**

##### *Entry qualifications*

238. The qualification requirements for entry to the profession are contained in the Consolidated Regulations of the Inns of Court. As for the solicitor branch of the profession (see Chapter IV) there are three stages: academic, vocational and pupillage.
239. The academic stage consists of a qualifying law degree (QLD), or the Common Professional Examination (the same exam for barristers and solicitors) following a degree in another discipline, or being accepted by an Inn as a mature student. Students are generally required to have at least a lower second degree in a QLD or other degree, and the Office of Fair Trading has advised the Lord Chancellor that this requirement is not unduly restrictive. Approximately 15,000 complete the academic stage each year.
240. The second stage is the Bar Vocational Course (BVC) which the Bar Council monitors and to which it appoints external examiners. Any institute of higher education can apply to offer a course and the number of providers of the BVC has increased from one in 1997 to eight institutions currently. Students generally finance themselves. There were 2,100 applications for the BVC this year but only 1,542 available places. However, the Bar Council puts no limit on the overall numbers of BVC places, and in the past two years not all the BVC places have been filled. 80% of BVC students have passed in the last three years, and there is



- no set quota for the number of passes. In July 1999, 1,238 students successfully completed the BVC.
241. An entrant to the barrister profession must also be called to the Bar by one of the four Inns of Court. To be called to the Bar the student must have completed the vocational stage and have 'kept terms' by attending 12 qualifying sessions. A qualifying session is an event of an educational or collegiate nature arranged by the Inn, e.g. a lecture or a mock trial that the student must generally pay for. The new entrant is not permitted to provide legal services (nor exercise rights of audience) under the title 'barrister' at this stage.
  242. The final stage is 12 months of in-service training known as pupillage. There are currently 683 pupillages registered with the Bar Council. In the first 'non-practising' six months a pupil cannot provide legal services as a barrister (save for being able to take a noting brief with permission from a pupil master or head of chambers. See paragraph 802 of the Code of Conduct). Traditionally, this time had to be served in chambers and was usually self-financed by the pupil. However, following a recent change to the Consolidated Regulations (precipitated by the Access to Justice Act) this first half of pupillage can now be spent wholly or partly in employment. On satisfactory completion of the first 6 months, the barrister is awarded a Provisional Qualification Certificate conferring full rights of audience. During the second 6 months (either in chambers or employment) the barrister may provide legal services, although under the new Code of Conduct the barrister must first have permission from the pupil master or head of chambers. The barrister, having completed pupillage, is then awarded a Full Qualification Certificate.
  243. After pupillage, there are two main routes for fully qualified barristers. The entrant may become either an employed barrister or - if the intention is to work as an independent barrister (i.e. become self-employed - secure a tenancy. Both employed and independent barristers must in their first three years after qualification practise from, respectively, an office or chambers where there is a qualified person with sufficient experience to offer professional guidance. Broadly speaking, this means a person who has practised for six out of the previous eight years, including the preceding two years, as a lawyer with rights of audience in all courts.
  244. The new Code of Conduct will make a Practising Certificate a pre-requisite for continued practice as a barrister (and the Access to Justice Act gives the Bar Council power to require payment of fees for these certificates). This new system will replace the unenforceable requirement to pay subscriptions to the Bar Council in 2003.
  245. It appears that there are fewer pupillages and tenancies available than there are applicants for them. According to data from the Pupillage Applications Clearing House (covering approximately 80% of Chambers and 68% of pupillages), in

1997 there were 1,842 applicants for around 700 to 800 pupillage places<sup>51</sup>. However, the constraint appears to stem from the self-employed, sole-practitioner nature of the Bar. There is no incentive for the established barristers to spend time coaching additional pupils, or to finance additional space for extra pupils or tenants. In a partnership or limited company, such costs might be borne as an investment, since the return would flow to the firm as a whole.

246. In our view there is no evidence that the entry qualifications for barristers are unduly restrictive (there is no evidence of a centrally-imposed restriction on the number of BVC places for example). The number of barristers has been growing and the recent slow-down in growth (see Figure 12 above) is in our view probably explained by the impact of government legal reforms and the withdrawal of local authority grants (see above). Moreover, the extension of opportunities made possible by the recent Access to Justice Act (the option to take pupillage in employment rather than in chambers) may help to address the shortage of pupillages and tenancies<sup>52</sup>. Nevertheless, if the Bar does, as has been suggested, shrink as a result of legal reforms, then opportunities could become more limited, although this in turn might merely serve to match supply and demand. A long-term decline in the barrister's role should not, however, inhibit competition.

#### *CPD requirements*

247. The New Practitioners Programme was introduced in 1997 (see the Code of Conduct - Continuing Professional Development Regulations) and is compulsory for all barristers who exercise or intend to exercise rights of audience. For the first three years, new practitioners must undertake a minimum of 42 hours further training in advocacy, case preparation and procedure, substantive law and/or professional ethics. The requirement was extended to the employed Bar from 1998. Over 400 courses are offered by Bar providers and several external providers.
248. By October 2004, new regulations will require all practising barristers to undertake CPD amounting to 12 hours per year (for which self-certification is proposed). Qualifying development can include lectures, courses, teaching and other approved activities.
249. In our view, these requirements do not appear unduly onerous and should not appreciably restrict or distort competition. We agree that some CPD is necessary and we regard the regulated minimum number of required hours as low.

#### **Indirect entry restrictions: demarcation**

250. Most demarcation restrictions affecting the Bar arise from its Code of Conduct (in contrast to the solicitors' profession, where they mostly arise out of statute). This

<sup>51</sup> Zander: *Cases and Materials on the English Legal System*, 1999.

<sup>52</sup> Although BACFI, in their submission, contend that new restrictions on who qualifies as a pupil master within employment will effectively prevent many employers offering such pupillages. An employer must now have two barristers with full rights of audience in order to comply.

is because barristers, unlike solicitors, have now lost all of their statutory monopolies or reserved areas of work. By contrast, solicitors are now permitted to do everything a barrister can do. Furthermore, barristers have chosen voluntarily to demarcate themselves through provisions in the Code of Conduct, such as a ban on direct access to most clients and a ban on independent barristers providing litigation services, in order to maintain the Bar as an independent referral profession. The Bar argues that this stance guarantees choice and competition and aids specialisation in advocacy skills. It also argues that voluntary demarcation aids smaller solicitors' firms who need access to advocacy services, and is thus pro-competitive.

251. However, these restrictions (discussed separately below), by preserving demarcation, could limit competition between solicitors and barristers for the same services. The Bar Council wants to maintain the traditional specialisation in advocacy (barristers) and litigation (solicitors). However, reforms to the legal system (see Chapter IV on solicitors) make this split less tenable.
252. We would not regard the continued use of the titles 'barrister' and 'solicitor' as detrimental to competition, assuming that action is taken on the restrictions on direct access to most clients and the right to conduct litigation, described in paragraphs 258 to 265 below. With these reforms in place, and given the ability of barristers and solicitors to transfer more easily between the two roles (a form of supply-side substitution), competition between barristers, solicitors and other professionals / practitioners should be adequate.

*Functional demarcation: advocacy*

253. Barristers are specialists in advocacy and their conduct and business structure restrictions are designed to reinforce this specialism. As noted in the Chapter on solicitors (Chapter IV), the barristers' monopoly over advocacy in the higher courts was lost following the Courts and Legal Services Act - although this legislation by itself has had relatively little practical impact. However, under the Access to Justice Act, all solicitors and barristers, including those in the Crown Prosecution Service (CPS) and employed barristers, are in principle qualified to appear in any court, subject to additional training requirements (see Chapter IV). It is anticipated that these reforms will increase competition in the provision of advocacy services.
254. Competition in the advocacy market should also be enhanced as the result of substitution on the supply-side of the market. It is becoming easier to transfer from the solicitor's branch to the Bar because requirements to do pupillage have been relaxed, depending on the solicitor's experience (see Chapter IV, paragraphs 163 to 167 for more detail). However, the Bar Council does not see a need for common training for solicitors and barristers because it remains wedded to the principle that two branches of the legal profession should provide separate

specialised functions (Collyear report, 2000)<sup>53</sup>. It is, nevertheless, looking at common outcomes for advocacy training.

255. Transfer in the other direction, from barrister to solicitor, has also been made easier (see Chapter IV, paragraphs 163 to 167 for more detail). The Qualified Lawyers Transfer Regulations 1990 govern the requirements for barristers switching to becoming solicitors. These have not substantially changed since introduction, but may have to do so because of the EU Establishment Directive<sup>54</sup>.
256. The Law Society received 184 qualified lawyer transfer applications from English and Welsh barristers during the first 10 months of 2000. According to Bar Council figures, about 70 solicitors apply each year to become barristers (Law Society Gazette 30 June 1999).
257. The competition issue in the provision of advocacy services was identified many years ago, and considerable reform effort has already been made. However, third-party perceptions may be limiting the number of solicitor-advocates competing in this market (see paragraphs 173 to 175 in Chapter IV for a full discussion of this issue). Numbers of solicitor-advocates should be monitored following the recent AJA 1999 reforms in this area.

*Functional demarcation: litigation*

258. There are restrictions on barristers undertaking litigation work, leading to a consequent reduction in competition between legal professionals. In particular, independent barristers are prohibited from competing for litigation work against solicitors and others, such as legal executives. The origin of this restriction is the barristers' Code of Conduct that bars independent barristers from undertaking the management, administration or general conduct of a client's affairs, or conducting litigation (401 (b)). It is reinforced by paragraph (307 (g)), which states that barristers must not handle client's money.
259. Under the Access to Justice Act the Bar Council became authorised to grant rights to carry out litigation. It is choosing to extend this right, however, only to employed barristers (and not to independent barristers). In addition, a working party of the Bar Council (the Sheldon report, 2000) recommended that 12 weeks on the job training was required for barristers who wish to take up this right. Nevertheless, they should still not be able to handle clients' money. These new rules are currently with the Lord Chancellor for approval under the procedure set down in the CLSA.

<sup>53</sup> 'Blueprint for the future', Final Report of the Committee chaired by Sir John Collyear FREng, May 2000.

<sup>54</sup> Implemented May 22 2000. Lawyers from EU countries don't have to take a test if (broadly speaking) they have practised for 3 years in another jurisdiction. This has implications for (amongst others) barristers from England and Wales because it would be anomalous if they had to take a test and EU lawyers do not. The Law Society is carrying out a major review of the implications.

260. The prohibition on carrying out litigation by independent barristers, according to Bar Council, is to ensure specialisation in advocacy and the continued existence of an independent Bar. The Working Party decided against an exemption to the rule on handling clients' money on the grounds that the Bar Council would need to institute a training and regulatory regime, perhaps including a compensation fund. This would impose a financial burden on the profession. It also argued that as employed barristers would only be supplying litigation services to their employers (as a result of a restriction set out in paragraphs 501/2 of the Code of Conduct), the exemption is unnecessary.
261. It is too early to gauge the impact of these reforms from the take-up of rights amongst employed barristers - and we do not have any evidence of the extent of latent demand amongst independent barristers to provide litigation services. Moreover, even if the right to conduct litigation is extended to independent barristers, one restriction currently in place that will inhibit the take-up of this right is the rule that only solicitors and certain other professionals can instruct barristers directly (see paragraphs 262 to 265 below). Nevertheless, the restrictions on independent barristers taking up these rights will, in our view, limit the number of competing lawyers conducting litigation, frustrating an underlying objective of the Access to Justice Act.

*Restrictions contributing to demarcation: direct access*

262. Under the Bar Code of Conduct (paragraph 401 (a)), independent barristers cannot supply services unless instructed by a professional client (e.g. a solicitor) or a 'BarDIRECT' client (a scheme that permits access to members of certain other professions). This restriction on direct access to clients inhibits competition between solicitors and barristers for certain types of work (where a client could instruct a barrister directly) and could add to clients' costs (where a client must pay for two professionals when one would have been sufficient).
263. In favour of the rule it is argued that direct access would add to regulatory costs in that it would need a compensation fund, accounting rules, and procedures for client care and complaints. These additional regulatory costs would be an unfair burden on those who want barristers to remain a referral profession. Defenders of the current restrictions also argue that barristers do not have the administrative structure to deal directly with clients and such a structure would ultimately add to the costs of providing their services. The Bar Council suggested that if barristers wanted to provide direct access, they should become solicitors.
264. An argument for reform is that new developments in legal services (such as the removal of other demarcation restrictions described above) mean that barristers may place themselves at a competitive disadvantage if they cannot sell their services directly to clients. Research suggests that in cases funded by conditional fees (introduced relatively recently), lack of direct contact with clients gives solicitors the upper hand over barristers in fee negotiations (Abrams and Yarrow, forthcoming). Moreover, the Bar Council suggested that solicitors do not always

inform clients that it might be cheaper to use a barrister than a solicitor-advocate. The reliance on solicitors to decide if the services of a barrister are necessary derives from an era when the two professions were not directly competing. With the breakdown of functional demarcation, lack of direct access to clients by barristers gives solicitors the power to cut barristers out of the market.

265. Our assessment is that this restriction limits the freedom of barristers who want to provide services directly - and there is evidence of some demand within the Bar for direct access. Getting rid of the rule would leave it up to individual barristers if they want to remain referral professionals. The restriction on direct access also forces clients to use two professionals rather than one (unless they instruct a solicitor-advocate, for example), potentially adding to costs.

*Demarcation within the barristers' profession: non-practising barristers*

266. The revised Code of Conduct takes a new approach to defining what a barrister is and sets out the requirements that a barrister must satisfy in order to qualify as such. They are intended to be similar to the concept of 'acting as a solicitor' under the Solicitors' Act. Consequently, it is now necessary for a barrister to have completed a pupillage. Previously, the Code of Conduct did not prevent those who could not get a pupillage from accepting instructions directly and providing legal services (other than advocacy) under the term 'non-practising barrister' (NPB). According to BACFI, many NPBs worked for solicitors' and accountants' firms, in the latter case as specialist tax consultants.
267. The Bar Council argues that it is against the public interest to have two kinds of barrister, one regulated, the other not. But appropriate regulation could be made a condition for using the title NPB. The Bar Council also claims that the use of the two terms confused consumers. Accordingly, this NPB status is now being phased out, after a five-year transitional period.
268. Although NPBs will continue to be able to offer legal services, they will not be able to call themselves 'non-practising barristers'. This prohibition could restrict competition for work that non-practising barristers are equally well qualified to undertake (given that they have completed all but the final stage of a barristers' training - see above). Indeed, the Lord Chancellor's Department is concerned that those who have been called to the Bar should be able to call themselves barristers and offer legal services (other than advocacy). In response, we learned that the Bar Council might decide to delay the call to the Bar until after the initial six months of pupillage, when pupils are awarded advocacy rights. The Lord Chancellor is unable to prevent the rule change, however, as it falls outside Schedule 4 of CLSA and so does not need the Lord Chancellor's approval.
269. There is very scant evidence about how many NPBs there are, or what services they offer. Only about 100 have registered with the Bar Council to continue using the NPB title. It is, therefore, difficult to evaluate the impact of this restriction on competition. However, we have not found any evidence that the use of the NPB

term confused or misled clients. The title itself clearly distinguishes an NPB from a traditional barrister. It is therefore unclear that the introduction of this restriction was necessary. Given that NPBs are not allowed to perform advocacy services, it appears to us to be a backward step to inhibit one additional (albeit limited) source of competition for non-advocacy services by abolishing the NPB title.

*Demarcation within the barristers' profession: QCs and the Junior Bar*

270. Originally Queen's Counsel (QC) were retained for royal work (QCs are appointed by the Queen on the advice of the Lord Chancellor), but the appointment is now described as 'a mark of eminence'. Juniors who wish to become QCs can apply to the Lord Chancellor's Department, and it is now open to employed barristers and solicitors to do the same. By 1999, four solicitors had been appointed QCs. Becoming a QC has also been the traditional pathway to the judiciary.
271. There is no formal reservation of any service to QCs. As the result of long-standing perceptions, however, the QC system results in an effective demarcation between the Senior Bar (QCs) and the Junior Bar in certain areas of work. For example, QCs do not normally do paperwork but concentrate almost entirely on advocacy. (According to paragraph 605 of the Code of Conduct, a QC in independent practice does not have to accept instructions to settle alone any document of a kind generally settled only by or in conjunction with a junior). Originally this demarcation was more rigidly enforced: there were rules of etiquette, for example, preventing a QC appearing in court without a junior ('double manning'), and entitling a junior to two-thirds of the QC fee. These rules were abolished, respectively, in 1977 following a Monopolies and Mergers Commission report (see Annex B) and in 1966 - although it is alleged that convention still means that QCs generally do not appear alone in court.
272. Arguments in favour of the QC system are that it is in the public interest to have a recognised elite of specialists, and that the QC badge acts as a quality mark. Furthermore, the Bar Council maintains that a QC's exemption from the cab-rank rule (see paragraph 284 below) in paragraph 605 of the Code allows QCs to specialise in advocacy without being bogged down in paperwork. Defenders of the system deny that double manning is the norm and argue that the appearance of two barristers reflects case loads and a sensible division of labour. There are a number of objective criticisms that can be made of the current QC system: the effective demarcation of certain services may distort competition between barristers and others (such as solicitor-advocates), and it may not operate as a reliable quality mark.
273. As noted earlier, the QC system leads to the effective reservation of certain types of work to QCs only (despite the removal of formal demarcation restrictions). This effective demarcation is enforced by the perceptions of judges, solicitors and lay clients. For example, a common belief is that it is necessary to have a QC in certain courts - or to match the other side's 'big gun' with one's own. It is also

suggested that a judge will listen to a QC's arguments with greater respect (for a discussion of the attitude to judges to advocates in general, see Chapter IV, paragraphs 173 to 175).

274. One sign that competition may be distorted is the step-change in fees that QCs are said to command following appointment (even though they are no more experienced than just before appointment). The precise extent of the difference was not made known to us, but we were told that it is substantial. It should also be noted that not all QCs are able to sustain these higher fee levels. This may be because potential clients do not consider some QCs to be of sufficient quality to justify the fees charged. Although the higher fees that QCs charge may simply reflect superior experience or quality, they may also be indicative of some form of quota. This quota may act as a barrier to entry to the Senior Bar and allow the incumbent QCs to charge fees higher than they would command in a more competitive market.
275. Numbers of QCs are not determined by the market but by the Lord Chancellor. In practice, they are limited to about 10% of the profession (see Figure 15 above). Although there is no official quota, the appointments system has some features that might indicate an unofficial quota. An appendix to the Kalisher Report (1994), attached at Annex E, provides some anecdotal evidence of an unofficial quota in operation a few years ago. If the QC system was truly a reflection only of quality, and quality standards were being maintained through the training system, one might expect the level of new QC awards to have risen roughly in proportion to the increase in the number of barristers in total. In fact, they have stayed fairly constant year on year (see Figure 14), at a level sufficient to maintain the number of QCs as a proportion of all barristers at roughly the 10% mark (see Figure 15). We think this might suggest some disguised quota arrangement.
276. Even if there is no quota in operation (and we do not have sufficient information to establish with certainty whether there is or is not), the appointments system (despite recent reform following the Peach report) does not appear to operate as a genuine quality mark. The system is secretive and, so far as we can tell, lacks objective standards. It also lacks some of the key features of a recognised accreditation system, such as examinations, peer review, fixed term appointments and quality appraisal to ensure that the quality mark remains justified. We were told that many solicitors and some barristers criticise the lack of objectivity of the system.
277. For other professional services it is has not proved necessary for the Government to intervene to distinguish the most expert practitioners. The profession itself should be capable of assessing, awarding and monitoring badges of quality without government intervention<sup>55</sup>. Even in the absence of a quality mark,

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<sup>55</sup> Particularly as many of the other restrictions imposed on the profession are justified on grounds that they visibly maintain independence from government. (See, for example, the prohibition on partnerships between barristers and the cab rank rule discussed below).



however, the evidence we have suggests that the market would be able to make informed choices without the aid of an accreditation scheme. Clients for advocacy services are usually very well informed as to the past performance and reputation of barristers (and other advocates) operating in their field. As a result, and because the pool of barristers is relatively small, particularly in specialist areas, they are normally capable of identifying and selecting the most appropriate provider without the aid of an accreditation scheme. Even with the current prohibition on direct access to clients by barristers, client awareness of service quality is likely to be high in the kinds of cases where top quality advocacy services are required.

278. In our view, therefore, the existing QC system does not operate as a genuine quality accreditation scheme. It thus distorts competition among junior and senior barristers. Our evidence indicates that clients do not generally need the assistance of a quality mark, but if there is to be such a scheme, it should be administered by the profession itself on transparent and objective grounds. Furthermore, there is some evidence that an informal quota is in operation within the current QC appointment system, and that it appears to have the effect of raising fees charged to litigation clients.
279. We do not think that a mark of quality or experience is necessarily anti-competitive, so long as the award is governed by transparent and objective criteria, and restrictions are based on qualitative, rather than quantitative, factors. On the evidence available to us, however, the current system does not pass these tests.

### **Indirect entry restrictions: permitted business structures**

#### *Prohibition on partnerships between barristers and incorporated practices*

280. Barristers are not permitted to practise in partnership with each other or form incorporated practices according to paragraph 205 of the Code of Conduct. This prohibition could prevent barristers adopting efficient (or innovative) units of production, raise costs and fees, and hamper competition with each other and with solicitors.
281. The rationale for the rule is that it maintains competition and choice. It is claimed that at present barristers compete as individuals, in that they have different fee rates, unlike fee-earners in solicitors' firms. In effect, therefore, there are some 10,000 competing suppliers. In addition, defenders argue, the rule allows members of the same chambers to act for clients with opposing interests. It also allows barristers to appear as advocates before another member of chambers sitting as a judge or arbitrator. There would be a conflict of interest if they were partners. Scrapping the rule, it is contended, would lead to an increase in the number of cases where there is only a barrister acting for one side (e.g. for the Crown or defendants in criminal cases), thereby undermining the cab-rank rule (see paragraph 284 below). Defenders of the rule assert that the impact of allowing partnership would be greatest in the most specialised areas of law, where

there are already only a very small number of chambers operating - for example in the areas of tax, patents and company law (see Figure 16 above) – and in smaller provincial chambers.

282. The prohibition also, however, prevents established and new barristers from choosing alternative business structures that may be more efficient or would allow them to share financial risk. It may also contribute to the entry barrier arising from shortage of pupillages and tenancies (see paragraph 245 above).
283. There are also questions over whether allowing partnership would affect competition to the extent claimed. Even under existing rules it is unclear to what extent barristers compete as individuals: barristers' clerks negotiate fees on behalf of all the barristers in their chambers; existing tenants of a chamber decide whom they want to join and can thereby limit competition within chambers<sup>56</sup>. The key point, however, is that greater flexibility over business structure should stimulate new entry to the markets in which barristers traditionally work, taking advantage of the opportunity to share business set-up risks or offer services more cheaply and efficiently as the result of economies of scale and scope. Allowing partnership would not, therefore, necessarily lead to a concentration of barristers in a few partnerships, particularly as those who wished to remain independent sole practitioners could do so. Moreover, the liberalisation of existing demarcation (see above) should provide other sources of competition; for example, in a specialist area such as intellectual property, from solicitors and patent agents.
284. According to the Code of Conduct (paragraph 601- 604), barristers supplying advocacy services cannot refuse to take on a case except in certain defined circumstances. This rule is intended to guarantee access to advocacy services so that persons are not *de facto* denied legal representation, and to preserve the independence of the Bar from Government influence or pressure.
285. Nevertheless, from a competition perspective the cab-rank rule could inhibit the formation of alternative business structures unless modified. As it stands, the rule is not compatible with partnership (barristers would have to consider the impact on partners before accepting a case). However, it should be possible to introduce alternative, less restrictive, means of safeguarding the Bar's independence and widespread access to legal representation. There has, in any case, been some erosion of this rule. For example, the Bar Council has waived it in cases funded by conditional fees, because it is not compatible with payment by results.
286. We conclude that the restrictions on partnership and incorporation along with the cab-rank rule may prevent barristers from adopting other forms of business structure (e.g. sharing risk with other barristers or non-barristers through a

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<sup>56</sup> Some decisions are taken at the level of the Bar as a whole, e.g. decisions to deny credit to particular solicitors' firms.

partnership). They may have the further effect of deterring entry (e.g. from potential barristers who are risk-averse).

*Prohibition on multi-disciplinary partnerships (MDPs)*

287. The CLSA (s66) states that no rule of common law prevents barristers entering into unincorporated partnerships with other professionals (such as solicitors), but that the Bar Council may make rules prohibiting or banning such partnerships. Accordingly, under paragraph 205 of their Code, barristers are not permitted to form partnerships with non-barristers.
288. The Bar Council opposes MDPs for similar reasons to partnerships between barristers, i.e. the impact on competition (see above). It also fears that barristers will join accountancy firms, thereby increasing market power of the big accountancy firms and causing a loss of access to barristers' services. In addition, there are regulatory concerns - especially about duties of confidentiality and legal privilege.
289. The arguments in favour of liberalisation are similar to those set out above for permitting partnerships between barristers. The rule preventing the formation of MDPs could inhibit potential new entrants, prevent the realisation of cost economies and the development of innovative combinations of services (e.g. a 'one-stop' shop focused on a particular segment of the market). It is also likely that solutions can be developed to address specific regulatory issues such as independence and conflicts of interest without the need to ban MDPs.
290. There has also been considerable debate in international lawyers' forums and within professional bodies in other countries on the issue. Although MDPs are permitted in some foreign jurisdictions, an international consensus has yet to emerge. Some foreign legal professional bodies (notably in Australia) have been applying themselves to developing models that address the potential risks in MDPs, such as differing professional standards, and conflict issues.
291. In our assessment, the current restrictions on the formation of MDPs are inhibiting competition, potential cost efficiencies and customer choice and convenience.

**Conduct restrictions**

*Advertising*

292. Advertising by barristers must conform to British Codes of Advertising and Sales Promotion. Under paragraph 7.10 of the Bar's Code of Conduct, there are also rules about the nature of advertising (e.g. it must not be inaccurate or likely to mislead) and its use (e.g. advertising must not be so frequent or obtrusive as to cause annoyance to those to whom it is directed). There is no ban on cold calling but there are prohibitions on:

- Direct comparisons with or criticisms of other barristers or members of any other profession (including fee comparisons); and,
- Statements about barristers' success rates.

293. Restrictions on truthful advertising (particularly those relating to fees) can inhibit information and consumer choice - and therefore effective competition for certain types of service and client. To the extent that barristers offer services that are not generally routine or standardised, and their clients are influenced by reputation and past performance rather than advertising, a liberalisation of these restrictions is unlikely to have a profound impact on competition. However, other potential reforms (such as the removal of restrictions on direct access to clients, business structure, and the provision of other services such as litigation) may conceivably lead to a future role for advertising in generating new business or facilitating new entry in markets catering for smaller scale clients. Furthermore, comparable empirical research strongly supports the removal of all unnecessary restrictions on advertising.

294. Overall, while we do not think that this restriction is having much effect on competition for the business of major clients, we think that it may have adverse effects in the case of small businesses and individuals.

#### *Controls on fees*

295. The Bar Council does not issue fee guidelines. Independent barristers can charge in any way they wish, as long as it is lawful and does not involve a wage or salary. Barristers receive fixed costs in fast-track cases, and are paid fixed rates for Community Legal Services work (formerly known as Legal Aid), as are solicitors. Assessment of costs by the courts also applies to barristers' fees.

296. Other than the role of the courts in the assessment of costs (discussed in Chapter IV on the solicitors' profession), there do not appear to be any restrictions related to barristers' fees that raise any issues for competition.

#### *Fee-fixing*

297. In theory, there are a large number of competing independent barristers (in total approaching 10,000 according to data shown at Figure 1). In practice, though, barristers belong to chambers and it is the clerks of chambers who tend to negotiate on behalf of individual barristers. Moreover, in some specialist areas - such as EU and competition law - there are only a handful of chambers with specialist expertise (see Figure 16). We found no evidence, however, to support allegations of collusion over fee rates between barristers' clerks. If any such collusion was taking place, a full extension of competition law to the professions would enable appropriate action to be taken.

## VI Restrictions in the accountancy profession

### Economic characteristics

#### Services provided

298. Accountancy services comprise statutory audit, a regulated activity (see the section below on regulation), and a number of other services which, in principle, anyone is free to perform. The latter include (but are by no means limited to) internal audit, advice on financial controls, preparation of management accounts, due diligence (where the financial state of a business, for example one which is offered for sale, is examined) and reporting accountant work (which is similar to due diligence but involves reporting to all potential investors under Stock Exchange rules). Accountancy firms also offer other services which make use of qualified accountants, such as the preparation of tax returns, tax advice and insolvency work.

#### Fees and profits

299. Data on the accounting profession are scarce. The only available significant fee income series is constructed from Top 50 firm surveys conducted by specialist publications such as *Accountancy Age*, *The Accountant* and *Accountancy*. The information provided characteristically covers only the largest firms in the industry: the Big Five<sup>57</sup>, the middle tier (Group A) firms, and some of the largest high street firms. PricewaterhouseCoopers and Arthur Andersen are increasingly secretive as to fee income, not even providing UK figures. Since these largest firms are partnerships and are not therefore obliged to publish their accounts<sup>58</sup>, the information provided by or about them may be, at the very least, non-comparable from year to year, and therefore to a degree misleading.<sup>59</sup>

300. If we accept the limitations of data provided, it appears that in 1998 the accountancy profession generated total fees of around £3.1 bn, or about 0.6% of the UK's Gross Domestic Product (GDP). Figures 17 and 18 show the growth in real UK fee revenue in the period 1988 to 1998 and the share of GDP that this represents (from 1986 to 1998). Figure 17 shows how accountancy fees, in real terms, rapidly increased between 1988 and 1991 (by 45% over these three years, decreased by about 1% between 1991 and 1995 and then increased again between 1995 and 2000 (by about 22%). The rapid growth in fees relative to GDP in the late 1980s (reflected in Figure 18) probably reflects the expansion at that time of accountants' advisory work, especially on mergers, acquisitions and flotations.

301. Over the period 1988 to 1998 the economic significance of the accountancy profession, measured as its revenues, increased substantially from approximately

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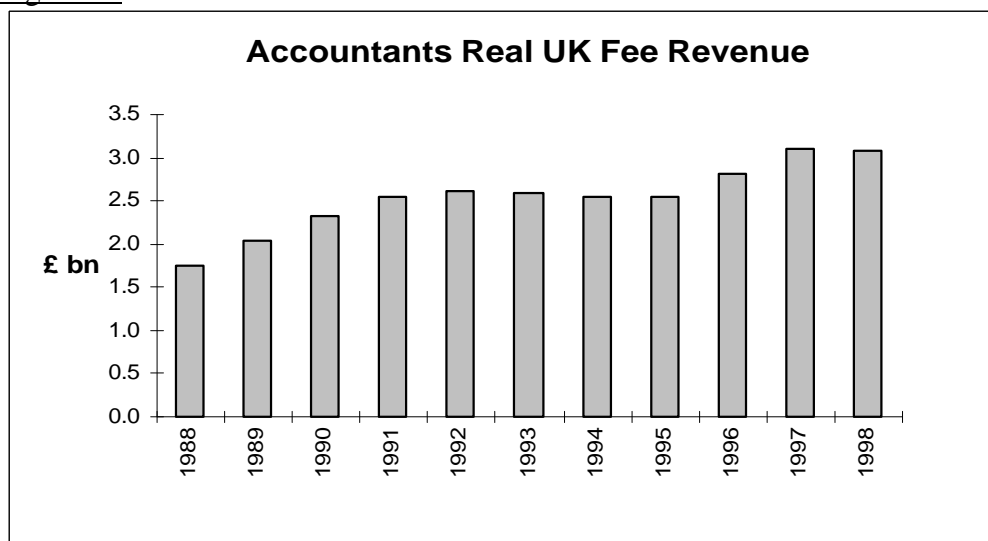
<sup>57</sup> PricewaterhouseCoopers, KPMG, Andersen Worldwide, Ernst & Young, Deloitte & Touche.

<sup>58</sup> For the firm as a whole. Where the partnership has subsidiary companies, accounts must be published for them.

<sup>59</sup> Particular difficulties arise because there is no agreed definition of accountancy services, and different firms divide their revenue differently between accountancy and other services.

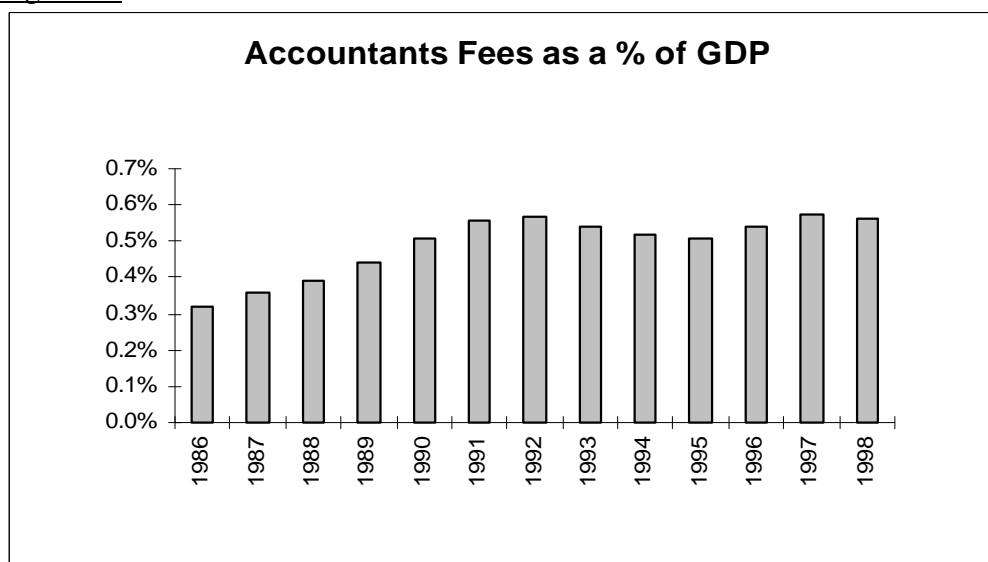
0.4% of GDP in 1988 to 0.6% in 1998. But profitability data for most accountancy firms is not available. Those few accountants where part of the practice has been set up as a limited company must of course publish accounts. Thus KPMG UK and Ernst & Young UK declared operating margins in 1999 of 27.6% and 25.9%<sup>60</sup> respectively. Operating profits for KPMG UK in 1999 were reported as £251.8m, representing an increase of 34% on the year before and for Ernst & Young UK £168.3m, an increase of 20% on the year before.

Figure 17



Source: Accountancy and Accountancy Age Magazines.

Figure 18



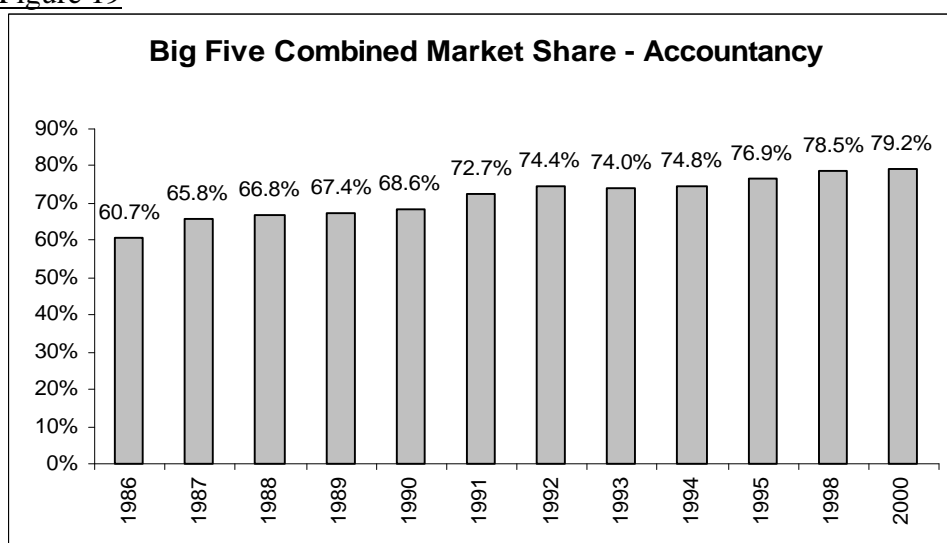
Source: Accountancy and Accountancy Age Magazines and Economic Trends Annual Supplement 1999

<sup>60</sup> Data taken from 1999 Annual Reports. Operating margin calculated as operating profit divided by fees net of direct expenses.

**Market structure**

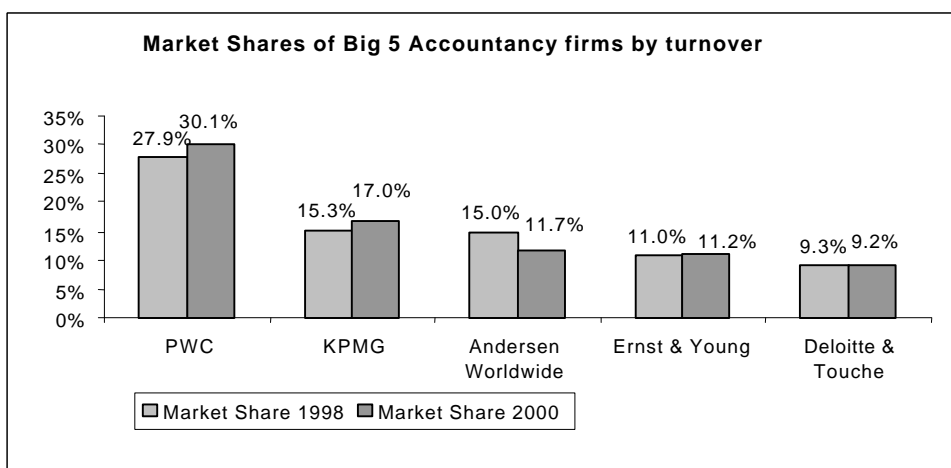
302. There are hundreds, if not thousands, of accountancy firms in the UK. These range from very small to very large firms with over 10,000 employees and UK turnover of £1bn or more from all activities. Five large firms –down in number from eight in 1989 as a result of mergers – stand out from the rest, both in size (Figure 19 and 20) and because each is part of an international network which uses a single professional name and covers most countries of the world. There is a perception, both among clients and among investors, that the highest quality of audit and other accountancy services is to be found in the Big Five.

Figure 19



Source: Accountancy and Accountancy Age Magazines

Figure 20



Source: Keynote Report Accountancy 2000

303. As Figure 19 shows, the top five firms have a market share in accountancy services as a whole of 79.2% in 2000. This understates the strength of the Big Five for a number of reasons:
- Multi-national clients often want their audit or other accountancy work to be done consistently round the world by a firm with global reach. Although the second-tier firms have tried to set up their own international networks, their coverage is only partial. Thus, only the Big Five effectively compete for this work.
  - Even large national companies often prefer to use a Big Five firm because they believe their investors feel more comfortable if their accounts are signed by a firm with a strong reputation. For supporting evidence on this and the previous point, see the European Commission's reasoning in its decision concerning the merger of Price Waterhouse and Coopers & Lybrand<sup>61</sup>.
  - Thus the five largest firms have gradually replaced the second-tier in auditing FTSE-100 companies. At most times, 100% of these companies are audited by the Big 5 (precision is impossible because the composition of the FTSE now changes so rapidly).
  - For particular pieces of work, there may be even fewer than five competitors because of professional conflicts. A firm may not, for example, undertake due diligence work on a company that it also audits. This alone reduces the number of available competitors to four, if client companies reason that second-tier firms are unlikely to be regarded as adequate. Moreover, in certain major transactions several different parties may be seeking due diligence services or the services of a reporting accountant from the same small pool of competitors. For example, two rival bidders for the same company could need due diligence work and neither might want to use an accountant retained by the other. Alternatively, a company may need to issue shares (necessitating appointment of a reporting accountant) and/or borrow from a bank in order to finance an acquisition, and the bank may want an accountant dedicated to its own needs rather than use the reporting accountant.
304. Thus, for services to the largest national and multi-national clients, the market for accountancy services is concentrated, and for some particular services highly concentrated. Figure 20 shows how the biggest of the Big Five have continued to expand their individual market shares: PricewaterhouseCoopers is now close to double the size of its nearest competitors.
305. Barriers to entry to this segment are also high: a new entrant would lack reputation and would find it difficult to build an international network (as established second-tier firms have found). A new entrant would also face a vicious circle in becoming established: it would be difficult to win business

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<sup>61</sup> Case No. IV/M 1016. See especially paragraph 28: “large multi-national companies...purchase audit services only from audit firms with both an international network and a recognised international reputation”. Also paragraph 29: “the Commission identified the Big 5 as the...exclusive providers of audit and accounting services to large national quoted companies, not for regulatory reasons but because the stock markets in general expect it.”

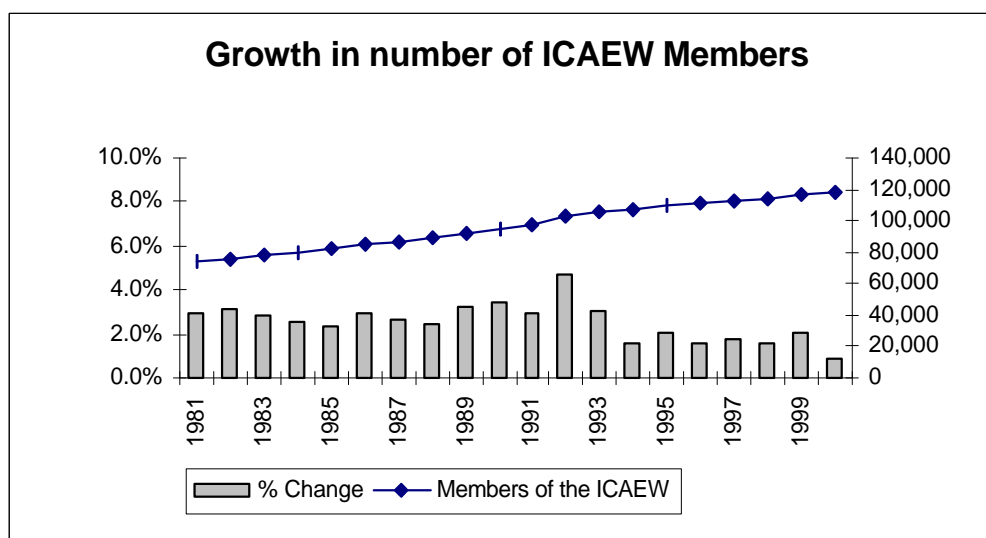


without adequate numbers of staff, and it would be difficult to attract staff until the firm had a substantial client base.

306. By contrast, services to smaller or unquoted companies, unincorporated businesses and individuals are provided by a very large number of accountancy firms and entry is not difficult, at least for services to individuals and small businesses.

### Numbers of accountants and their earnings

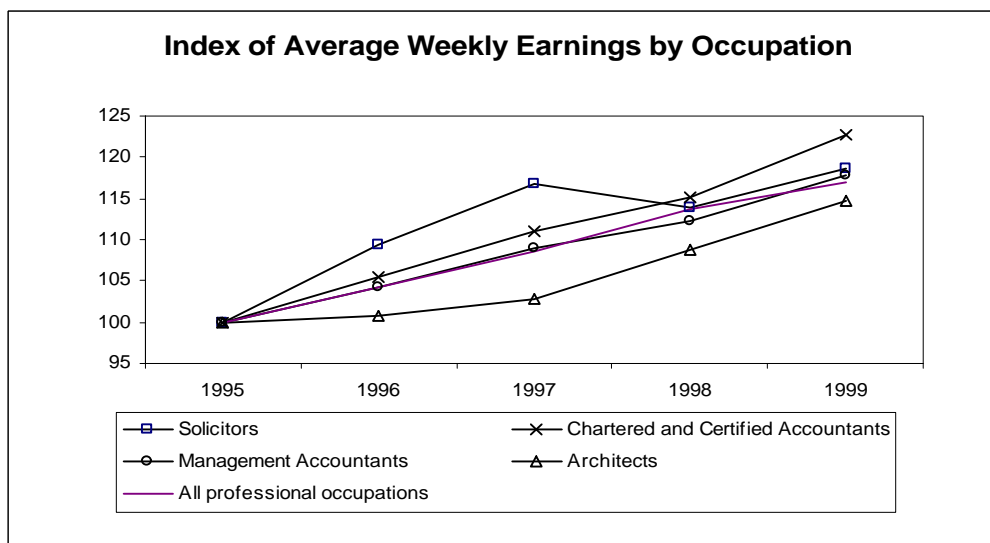
Figure 21



Source: ICAEW Website October 2000.

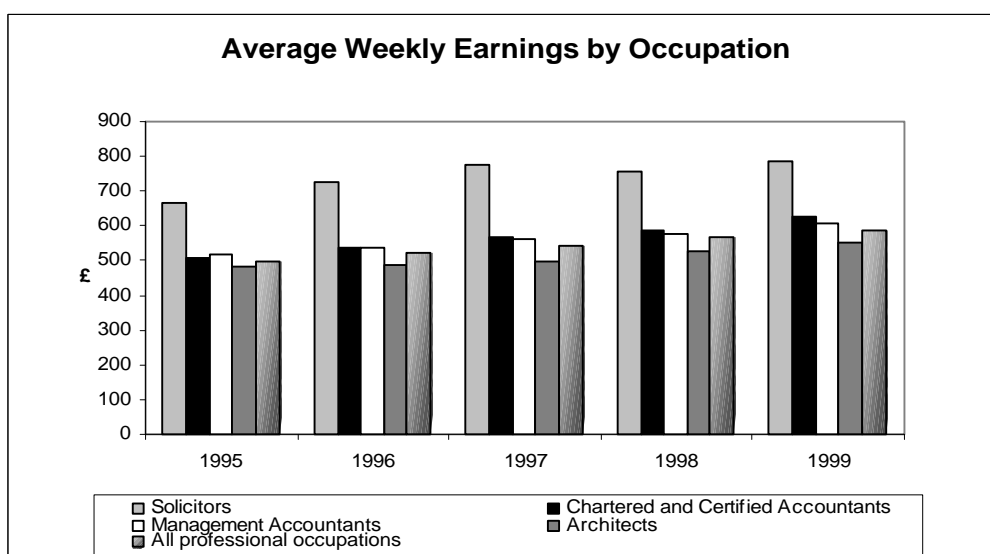
307. Figure 21 shows the number of ICAEW members from 1981 to 2000, and the annual growth rate in membership. There is positive growth throughout the period, with the yearly growth peaking in 1992 at 4.7%. However, after 1992 we witness a fall in the rate of year-on-year growth, which stabilises at around 1.5-2% until 1999, and then falls again in 2000 to below 1%. This fall in growth may not be representative of the profession as a whole: there may be other reasons why ICAEW membership is not growing as rapidly as in previous years, for instance it is possible that other professional bodies have becoming relatively more attractive. However, on the assumption that ICAEW membership was an accurate proxy for the total number of registered accountants, we investigated the reasons for the slowdown (see paragraphs 314 to 317 below).

Figure 22



Source: The New Earnings Survey 1995-99

Figure 23



Source: The New Earnings Survey 1995-99

308. Data on the relative earnings of accountants are presented in Figures 22 and 23. Starting from a base of 100 in 1995, the index of chartered and certified accountants average weekly earnings stood at 122.6 in 1999 (117.9 for management accountants), i.e. earnings increased by 22.6% and (17.9%) over the period. This compares to an increase in average weekly earnings over the same period of 18.6%, 14.8%, and 16.9% for solicitors, architects and all professions. Figure 23 shows the absolute values of average weekly earnings. In 1999, accountants earned £624.10 (chartered and certified) and £607.10 (management),

compared to £787.90, £554.40 and £584.30 for solicitors, architects and all professions respectively.

### **Regulation of the accountancy profession**

309. Statutory regulation of the accountancy profession is limited to three areas; statutory audit, investment business, and insolvency. Only statutory audit is restricted exclusively to the accountancy profession. Within the accountancy profession, statutory audit is restricted to registered firms of the recognised supervisory bodies (RSBs)<sup>62</sup>: the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants in Scotland (ICAS), the Institute of Chartered Accountants in Ireland (ICAI), the Association of Chartered Certified Accountants (ACCA), and the Association of Authorised Public Accountants (AAPA).
310. Statutory audit rules are laid out in the Companies Acts 1985 and 1989 and reflect the EU 8<sup>th</sup> Company Law Directive<sup>63</sup>. The Department of Trade and Industry (DTI) designates professional bodies as RSBs, and it is the RSBs who then carry out the monitoring, supervision, and maintenance of professional standards. It is thus a system of self-regulation supported by statute and by government involvement.
311. The Institute of Chartered Accountants in England & Wales (ICAEW) has over 118,000 members. Members are entitled to call themselves "Chartered Accountants" and to use the designatory letters ACA or FCA.<sup>64</sup> The Association of Chartered Certified Accountants (ACCA) is the second largest of the chartered accountancy bodies in the UK with nearly 75,000 members and over 150,000 students.
312. There are a number of other professional accountancy bodies which do not act as RSBs for statutory audit. Two of these bodies have chartered status. They are the Chartered Institute of Management Accountants (CIMA) and the Chartered Institute of Public Finance and Accountancy (CIPFA). CIMA members generally work in business. They have a small number of members in professional practice - not in reserved occupations such auditing - but in the role of advisers and consultants. CIPFA is responsible for the education, training and regulation of professional accountants working in the public sector.
313. There is a further important superstructure of self-regulation over and above the chartered bodies described above. This takes the form of the Consultative

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<sup>62</sup> In addition, there are Recognised Qualifying Bodies, which are the ICAEW, ACCA, ICAS, ICAI, and also the Association of International Accountants (AIA). The AIA is only a qualifying body, and does not regulate auditors. Any practising AIA-qualified auditor would have to be supervised by one of RSBs. Therefore, for simplicity we will refer to statutory audit as restricted to those regulated by the RSBs.

<sup>63</sup> The full title is the European Council Eighth Company Law Directive on the Regulation of Auditors, and it dates from 10th April 1984 (84/253/EEC).

<sup>64</sup> Response of ICAEW, p.2

Committee of Accountancy Bodies (CCAB). The CCAB was established in 1974 by six major accountancy bodies. It is now a limited company with six members: ICAEW, ACCA, CIMA, CIPFA, ICAS, and ICAI. Four members are RSBs for statutory audit, two are not. The CCAB aims to promote the advancement of the standing and effectiveness of the accountancy profession in the United Kingdom and Republic of Ireland. Where appropriate, it takes a role as representative of the accountancy profession on international committees, government and governmental bodies.

314. The CCAB bodies have been working closely with the DTI to implement plans to establish an independent framework for regulation of the accountancy profession. A Foundation has been established under the Chairmanship of Lord Borrie (a former Director-General of Fair Trading) to oversee the new system. The new regulatory framework will comprise a Review Board, a new Auditing Practices Board (to replace the current APB), a new Ethics Standards Board and an Investigations and Discipline Board (to replace the Current Joint Disciplinary Scheme).<sup>65</sup> Currently, the CCAB members are the only accountancy bodies which are members of this new system.

### **Assessment of individual restrictions in the accountancy profession**

#### **Direct entry restrictions**

315. It is not necessary to have any formal qualification to call oneself an “accountant”. Qualification with one of the accountancy bodies involves a combination of examinations and practical experience. The normal route is to obtain a training contract from an accountancy firm. We were told that individuals who could not secure a training contract could apply for the first-stage examinations as independent candidates, although they would still need to find a firm to give them practical experience before they could take the final examinations and qualify.
316. Typically, the entry qualification to begin training is two A-levels. This is, for example, the minimum requirement of the ICAEW. In practice, we were told that the large firms took only graduates. This practice might be regarded as limiting the numbers coming into the profession, but it does not stem from any professional rule and, unless there were evidence that the firms were colluding (and we are not aware of any), there would be no case for interfering with independent commercial decisions. If there were unexploited opportunities to employ more accountants, it would be rational for one or more of the big firms to change its recruitment policy in the hope of securing a competitive advantage.
317. Statistics on the growth of ICAEW membership (see Figure 21) show a slowdown after 1992. Yet over this period, demand for accountancy services was strong, as a result of a buoyant economy and an upturn in mergers and acquisitions (which

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<sup>65</sup> Response of CCAB, p.3

generate substantial demand for accountancy services). We were given various explanations for the falling numbers, including:

- Increased automation of the audit process, creating demand for a few, highly expert staff rather than large numbers of “number-crunchers”.
- Recruitment of lower-cost accounting technicians to do routine tasks in place of higher-paid chartered accountants.
- Recruitment of other professionals equally capable of delivering some of the firms’ services which had traditionally been done by accountants, for example, people with a qualification from the Institute of Taxation.
- On the supply side, a rise in the numbers of competing employers of people who might consider accountancy as a career (e.g. banks).

318. On the evidence available to us, we conclude that the apparent decline in numbers of accountants (assuming ICAEW membership is an accurate proxy for the size of the profession) is not due to any restriction of a professional body. It appears to stem from the independent decisions of the firms who employ accountants. If there were other grounds for suspecting collusion or parallel behaviour between the Big Five, recruitment would be one issue to consider, but of itself it is not sufficient to raise concerns.

### **Indirect entry restrictions**

#### *Restrictions on permitted business structures*

319. Restrictions on the permitted business structure and composition of accountancy firms may create a barrier to entry at the level of individual firms (rather than for individuals). Accountancy firms which carry out statutory audits and are therefore registered with an RSB (see the section on demarcation below) must comply with the statutory requirements of the Companies Act 1989, which among other things requires that control of the firm (i.e. a majority of voting rights) must be in the hands of ‘qualified individuals’. The key requirements for ‘qualified individuals’ are that they must hold an appropriate qualification as defined by section 31 of the Companies Act 1989 and that they must be a member of the ICAEW, ICAS, ICAI or ACCA (effectively the RSBs - other than AAPA, which has been taken over by ACCA) with a current Practising Certificate or affiliate status.<sup>66</sup>

320. The aim of these restrictions is to guard against ‘undue pressure’ from parts of the firm that may damage the integrity of audit work. They implement a requirement of the EU 8<sup>th</sup> Company Law Directive. However, the ICAEW told us that it would welcome discussions on amending the law to allow the promotion of MDPs, while preserving the ethical integrity of auditors.

321. In the DTI’s view, the 50% rule inhibits large non-accountancy firms from entering the market through the acquisition of small high street firms. Such firms may see opportunities in terms of increasing management efficiency, and the

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<sup>66</sup> Response of ICAEW, p.8

example of American Express in the US was cited. According to the DTI, there have been discussions about how to get round the 50% rule through contractual arrangements that could maintain auditor independence but would allow non-accountancy firms the opportunity of increasing the efficiency of high street accountancy firms.<sup>67</sup>

322. The 50% rule is also one of a group of rules that influence commercial decisions over the composition of a firm as regards professionals in partnership and employment. In particular, these rules inhibit the formation of fully-fledged Multi-Disciplinary Partnerships (MDPs). Given that the accountancy and legal professions are natural complements in many areas of business, any judgement on the 50% rule needs to take account also of restrictions imposed by professional bodies representing lawyers, the most significant of which is Rule 7 of the Solicitors' Practice Rules 1990, which restricts a solicitor's ability to share professional fees with other persons (see Chapter IV).
323. These restrictions on MDPs have potential competition effects in that they may inhibit new entry and prevent the exploitation of possible economies of scale and scope. MDPs might achieve advantages in branding, overhead cost savings, the ability to transfer resources in response to fluctuations in demand and a seamless service to clients. All these factors could increase the intensity of competition (in both accountancy and legal markets). These are arguments against the restrictions imposed by both professions and liberalisation would require abolition of the accountants' 50% rule as well as restrictions imposed by the Law Society.
324. The evidence we have suggests that the strongest advocates of MDPs are the Big Five accountancy firms. KPMG believe that a relaxation of these restrictions (subject to appropriate regulatory safeguards) would allow increased competition in the provision of legal and other professional services, which they believe would be to the benefit of the purchasers of such services<sup>68</sup>. This view is broadly supported in the responses of PricewaterhouseCoopers<sup>69</sup> and Ernst & Young<sup>70</sup>. Arthur Andersen suggest that regulation should be at the individual rather than the firm level. They also highlight customer demand for more integrated professional services.<sup>71</sup>
325. Given the strong market position of the Big Five firms, there is some risk that permitting MDPs would allow them to leverage whatever market power they have from accountancy markets to legal service markets. If, however, the professions were subject to the full force of competition law (one of our overall recommendations set out in Chapter IX) such moves could be investigated on a case-by-case basis and adverse effects remedied.

<sup>67</sup> Interview of the DTI, 20/10/00

<sup>68</sup> Response of KPMG, p.5

<sup>69</sup> Response of PwC

<sup>70</sup> Response of Ernst & Young

<sup>71</sup> Response of Arthur Andersen, p.3

326. We conclude that the 50% rule is a significant restriction of competition. Because it implements a requirement of the 8<sup>th</sup> Directive on company law, its reform would have to be implemented at European level.

### **Demarcation**

327. The term “accountant” enjoys no special status in law, and anyone is free to describe himself or herself as an “accountant.” However, as we described above, there are three service areas where practice is demarcated by statute (statutory audit, investment business and insolvency). Two of these areas, statutory audit and insolvency, were raised in the consultation process as potential competition issues. We consider audit here: on insolvency see Chapter VIII.

#### *Demarcation: Statutory audit*

328. The statutory audit restriction effectively limits competition for statutory audit work to the registered firms of the RSBs. The origin of this restriction is the Companies Acts of 1985 and 1989 which, in turn, reflect the EU 8<sup>th</sup> Company Law Directive. This demarcation restriction is intended to maintain professional standards in an important area of assurance for company stakeholders (i.e. where significant “externalities” exist – see Chapter II). This restriction would not unduly restrict competition provided either that there is sufficient competition between auditors who are registered with existing RSBs, or that RSB status is open to all accountancy bodies on a transparent and objective basis.
329. Any professional body can apply to the DTI to be designated as a recognised supervisory body and the criteria that an applicant body would need to fulfil are set out in the Companies Act 1989. On this specific issue ACCA (one of the existing RSBs) considered the RSB qualification to be ‘entirely clear’. Moreover, CIPFA, an organisation which told us that it is currently considering the option of applying for designation of RSB status, had no particular problems with the system of RSB qualification at this stage but were going to consider the matter further.<sup>72</sup> On the specific issue of an application from CIPFA, the DTI told us they would have an ‘open mind.’<sup>73</sup>
330. However, the DTI did highlight the large entry costs involved in becoming a RSB since RSBs need to have in place a significant monitoring operation.<sup>74</sup> The DTI also mentioned a ‘needs’ test (that is, a policy of not designating new RSBs unless the existing ones were inadequate) under the Companies Act 1989. It is therefore not entirely clear that entry to RSB status remains open to new bodies.
331. We do not, however, believe that this has any significant effect on competition. Four separate bodies are already RSBs: this is a large number by the standards of professional regulation. More importantly, there is a very large number of

<sup>72</sup> Telephone Interview of CIPFA, 30/10/00

<sup>73</sup> Telephone Interview with the DTI, 2/11/00

<sup>74</sup> Telephone Interview with the DTI, 2/11/00

competing audit *firms*. The evidence is that audit is the most competitive segment of the accountancy market. For example, the One Hundred Group told us that its members had been able to secure substantial reductions in audit fees (in real terms) in recent years. If there is any concern about inadequate competition, it relates to the fact that only five firms are in contention for major and/or international audits. But making it easier for additional bodies to be designated as RSBs would have no effect on the market power of the Big Five.

*Demarcation: application of statutory audit rules to other accountancy work via third party perception*

332. Over and above any competition impacts explicitly caused by the reservation of statutory audit, many respondents to the OFT's consultation highlighted concerns over third party perceptions about the reservation of statutory audit to RSB registered firms. The Institute of Financial Accountants, for example, stated that "*in many cases lending sources will not accept accounts unless they have been prepared by a Chartered Accountant. The result of this is that clients will have to pay a higher fee than is necessary.*"<sup>75</sup> In other words, third party perceptions may be extending the demarcation restriction for statutory audit (where it is justified in terms of the externalities involved) to other areas of accountancy work where such a limitation on competition is not warranted.
333. The problem of demarcation restrictions extending to services other than statutory audit is compounded by confusion (amongst professionals as well as potential consumers) over the respective roles of the CCAB, the new regulatory framework and the RSBs in respect both of representation and regulation. As described earlier, the CCAB bodies have recently been working closely with the DTI to establish an independent framework for regulation of the accountancy profession. A number of respondents to the OFT's consultation highlighted fears that this new regulatory body may be exclusionary, unrepresentative and may – as a result of consumer misconception - prevent non-CCAB accountants from competing effectively for work they are equally well qualified to undertake.
334. The AIA<sup>76</sup>, for example, claim that the CCAB promote themselves as representatives of the accountancy profession as a whole but in fact represent only accountants with chartered status, and that the new regulatory framework may serve to reinforce this misconception. According to the AIA, it is left to the new regulatory body – The Accountancy Foundation – to consider the possible expansion of membership in the future. This view is confirmed by the DTI, who state that it would be up to the new Accountancy Foundation to consider whether other bodies should be accepted into the new arrangements. The DTI reported that the Foundation had already considered a request from a non-CCAB body, but

<sup>75</sup> Response of IFA, p.2 Although the RSBs and the chartered accountancy bodies are not co-extensive, there is considerable overlap.

<sup>76</sup> Association of International Accountants



concluded that further consideration of the issue should wait until after the framework bodies have been established.<sup>77</sup>

335. To add further to the confusion, there are two inter-linked areas of regulation. The first is statutory audit, which comes from the Companies Acts<sup>78</sup> through the RSBs. The second is the CCAB<sup>79</sup>, now also represented by the Accountancy Foundation<sup>80</sup>, endorsed by the DTI. However, four of the six members of the CCAB are also RSBs for statutory audit, and not only does the Accountancy Foundation have a general role, but through one of the CCAB boards, the APB, it has a role in monitoring statutory audit.
336. A positive note is sounded by the AAT<sup>81</sup> who now consider that they have overcome the perception problem and have achieved the recognition of most large banks and building societies for basic referencing tasks.
337. Nonetheless, given the current state of flux in the regulatory structures for the accountancy profession and the apparent degree of confusion caused thereby, there seems to us a danger that accountants, and accountancy firms, who are perfectly well-qualified to provide certain services will become less effective competitors because their professional bodies do not come under the new regulatory framework. It seems to us that the interests of both professional regulation and competition would be served by bringing all accountancy bodies under this framework.

*Demarcation: Statutory audit requirements and other Acts*

338. A related issue, highlighted by CIPFA amongst others, is the linkage between statutory audit requirements and the audit requirement of other sector-specific Acts. The Charities Act 1993 and the Charities (Accounts and Reports) Regulations 1995 reserve audits of charities with gross income or total expenditure exceeding £250,000 to registered auditors (i.e. RSBs registered firms). The Friendly and Industrial and Provident Societies Act 1968 and the Housing Act 1996 also link the external audit requirements for registered social landlords to the Companies Act requirement for registered auditors.
339. The main issue here is the threshold at which an audit by an RSB member is mandatory. Although the effect of having lower thresholds for charities and social landlords than for public companies is to exclude non-RSB registered firms from the market, it does not raise any different issues from the general RSB system. Once again, market evidence suggests that there is no competition problem. Charity audits, for example, are often carried out free, or for a nominal

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<sup>77</sup> Enclosed DTI letter, 31/3/00, of the Response of the London Society of Chartered Accountants

<sup>78</sup> The Companies Acts reflect the EU 8<sup>th</sup> Company Law Directive.

<sup>79</sup> Although no new areas of work will be statutorily reserved under the Accountancy Foundation framework.

<sup>80</sup> It is not important for perceptions that the Accountancy Foundation draws its membership partly from outside the profession. It is the fact that it oversees and is representative of the CCAB bodies.

<sup>81</sup> Association of Accounting Technicians

fee as “pro bono” work by otherwise commercial firms. No-one has suggested that charities or social landlords are paying too much for their audits.

340. Some respondents also criticised the decision to raise the threshold at which small companies need a statutory audit. This does not seem to us to raise competition issues. Rather, it is a reduction in the demand for a service, stemming from government desires to reduce burdens on small businesses.

*Demarcation: Use of the term “chartered accountant”*

341. As noted above, some accountancy bodies have chartered status, while others do not. The ICAEW requires that, for a firm to call itself “A, B & C, chartered accountants”, a majority of the partners (directors in the case of a company) must be members of one of the chartered bodies and a majority of the voting rights must be held by such members<sup>82</sup>. It might be argued that this raises similar issues to use of the title QC in the legal profession (see paragraphs 270 to 279).

342. We do not, however, see a competition problem here. Unlike QC status, the title “chartered accountant” is available immediately to anyone who qualifies with one of the chartered bodies. There are a number of such bodies and there is no suggestion that any of them impose a quota on entry. Moreover, although the title “chartered accountant” still has some impact on client perceptions, the important divide is that described earlier in this chapter, between Big Five firms and the rest. Given the relative ease of obtaining the title and its limited market significance, we do not believe that its use restricts competition.

**Conduct restrictions**

343. Conduct restrictions with potential competition impacts highlighted by respondents to the OFT’s consultation included fee fixing, fee sharing and collusion. These restrictions have particular significance for price competition in markets where some firms are likely to have market power (see the earlier section on market structure).

344. An allegation was made by two respondents to the consultation (one of whom wished to remain anonymous) that the major firms operated a fee cartel. No supporting evidence was given and we have found no evidence to back it up. If any such cartel was in place, however, a full extension of competition law to the professions would enable appropriate action to be taken.

*Cross-subsidy between different services*

345. Certain second-tier firms have for some years alleged that the major firms have priced audit tenders in a quasi-predatory way (“low-balling”), expecting to compensate for losses or low margins on audit because they are then in a favoured position in seeking other, higher margin accountancy work from the company in

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<sup>82</sup> The remaining partners or directors must either be affiliates of a chartered body or undertake to be bound by its rules.

question. These allegations began after second-tier firms lost some of their remaining large client audits.

346. If there is any truth in these allegations, the problem does not seem to stem from professional rules. The only regulated service is statutory audit, and if regulation was having the effect of restricting competition in, or entry to, the audit market, one would expect to see high profits in audit, which could then be used to cross-subsidise “low-balling” in other accountancy work. But the nature of the complaint is that audit profitability is *too low*, a proposition for which there is considerable anecdotal support. The One Hundred Group, for example, believes that their members had succeeded in forcing down the price of audit, but expected to pay higher rates for special accounting work.
347. Moreover, the allegation only makes sense if one makes the assumption that the second-tier firms have a realistic chance of winning or retaining these audits. If they do not, it does not matter how the Big Five price. If the second-tier are also effective contenders for the non-audit work, there is no reason why they too should not price their audit bids low and aim to recoup their losses from other, high-margin accountancy work. There are many markets where one product shows higher margins than another, because customers are more price-aware and price-sensitive on the latter. Such markets may nonetheless be competitive<sup>83</sup>.
348. If, on the other hand, the second-tier firms are not effective contenders even for non-audit work, it is not clear what the Big Five would have to gain from predatory pricing against them. Since they would not have to compete against the second-tier firms for non-audit work anyway, there would be no advantage from driving them out of the unprofitable audit market.
349. A further possibility is that this is not an issue of cross-subsidy at all, but one of straightforward predation. The question then is whether a strategy of predation against the second-tier in audit would make commercial sense. Given that five major players remain in the market, even when all the second-tier firms have been dislodged from the FTSE 100 segment, it is doubtful that the Big Five have been engaged in predatory pricing. A more likely explanation is that they were competing fiercely on price against each other and the second-tier firms were caught in the crossfire.
350. Thus we cannot conclude that any restriction on competition arising from professional rules, or of abusive or parallel behaviour, arises from this complaint.

#### **Advertising / marketing restrictions**

351. A clear conduct issue with the potential to impede competition in the accountancy profession is advertising restrictions. The few remaining restrictions on advertising imposed by the professional bodies include a prohibition of fee

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<sup>83</sup> For example, the MMC found the market for recorded music to be competitive, despite the fact that all companies made much bigger margins on CDs than on cassettes.

comparisons with other firms (though advertising of one's own fee rates is permitted) and on "cold-calling", that is, telephoning people who are not clients to offer them services. Offering services in writing, or in the course of a meeting having some other purpose, such as a seminar, is permitted. There are also restrictions on payment for business referrals (e.g. from firms providing on-line market-places).

352. The ICAEW Members Handbook 2000 contains rules on fee advertising, cold-calling and payment for referrals. The ICAEW restrictions are broadly representative of restrictions across the profession including the chartered accountants, RSBs for statutory audit, and other non-CCAB, non-RSB bodies. The ICAEW Guide to Professional Ethics (section 1.211 page 275) states that:
- Members should not make comparisons between their fees and the fees of other accounting practices;
  - Promotional material may be sent to non-clients by mail, but members should not make unsolicited visits or telephone calls to non-clients;
  - Introduction fees should not be paid except to employees, comparable public accountants, or authorised investment business firms.<sup>84</sup>
353. There is a range of variations on these restrictions imposed by the other professional bodies. CIMA's rules stand out because they ban the quotation of fees altogether. ACCA on the other hand is a notable exception since it generally relies on the British Code on Advertising Practice and ITC Code of Advertising Standards and Practice.
354. The ICAEW told us that they were now in discussion with the ICAS and ICAI with a view to removing both the ban on comparative fee advertising and that on cold-calling. Other interviewees were generally surprised and unaware of any restrictions on advertising. In general, their belief was that there was no special reason why accountancy should need restrictions over and above those for other products and services.
355. We think it unlikely that these restrictions have much effect on competition for the business of large clients. Such clients usually base their buying decisions on reputation, previous work carried out by the firm and personal relationships. They are unlikely to go to a firm which they would not otherwise have considered as a result of seeing a comparative-fee advertisement or receiving a cold call.<sup>85</sup> This is quite consistent with the proposition that they will compare fees when they invite selected firms to tender, at which stage the professional rule has no effect.

<sup>84</sup> Response of ICAEW, p.10

<sup>85</sup> The One Hundred Group did refer to a culture among UK accountants and lawyers of not approaching clients to offer innovative solutions to problems (although the same professionals could be innovative if the client put the question to them). There may be some link between this culture and the ban on cold-calling, but it is hard to separate cause and effect.

356. At the smaller end of the market, however, these restrictions could well be restricting competition. An individual requiring help with a tax return, or a small business starting up, may care or know much less about the reputation of any particular firm and may be much more cost-conscious. Advertising could well be an effective competitive weapon in this segment and an advertisement which asserts that a particular firm charges 20% less than its rivals might be a good promotional move. By the same token, cold-calling is more likely to be effective where the potential client is unsure where to go to find accountancy support.
357. Additional support for the removal of the remaining restrictions on advertising is provided by empirical research (see Chapter II) which strongly supports the removal of all unnecessary restrictions, and from the majority of interviewees who did not consider accountancy to be a special case in this respect. We agree with these views.
358. We believe that restrictions on the referral of business is inhibiting the development of on-line accountancy marketplaces (a potential new spur to competition). The ICAEW intend to lessen these restrictions considerably. Firms will be permitted to pay for referrals, so long as the referring firm acts in accordance with ethical standards comparable to those of the accountancy firm, and provided the client is aware of the arrangement. This should deal with the problem (so far as the ICAEW is concerned) so long as it is up to the individual firm to decide whether the referrer is an ethical source of business, rather than the Institute.

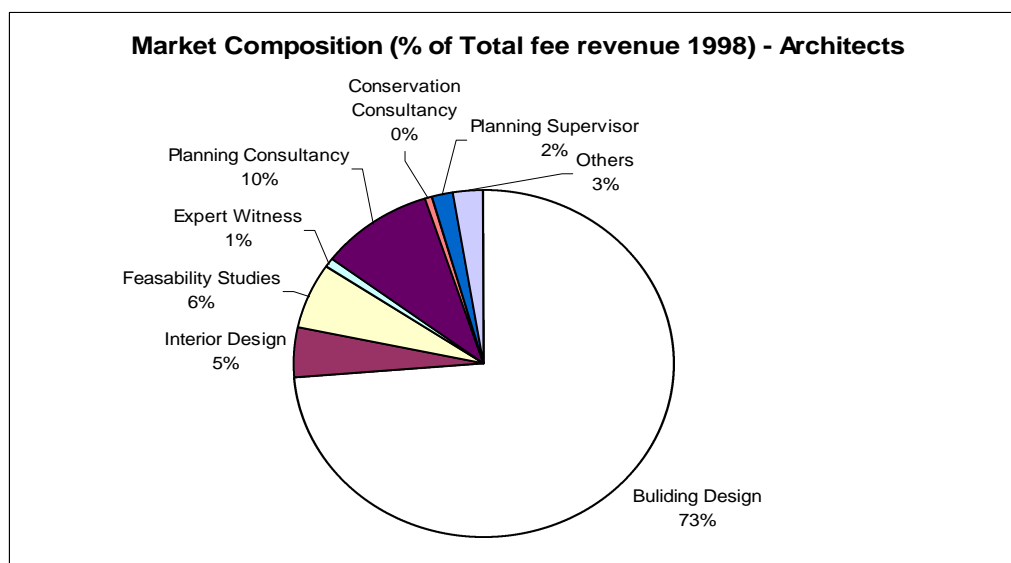
## VII Restrictions in the architecture profession

### Economic characteristics

#### Services

359. The Architecture profession is particularly focused on building design (see Figure 24). In 1998, 73.6 % of Total Fee Revenue came from building design<sup>86</sup>. It appears *prima facie* that architects have not diversified away from their core design function into other aspects of the building process.

Figure 24



Source: Mirza & Nacey Research, Architects Performance 1999

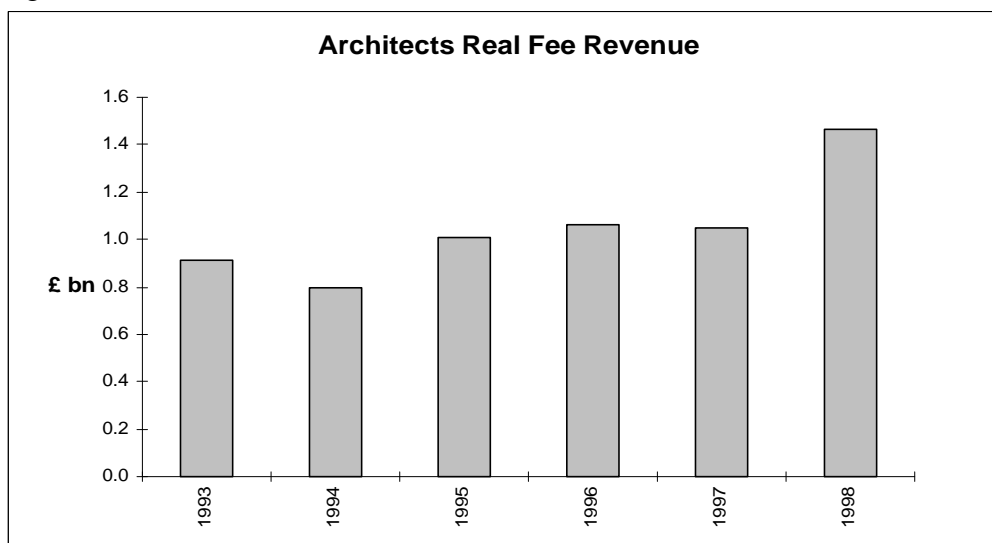
#### Fees and profits

360. Architects' total fee revenue in real terms<sup>87</sup> was £1.47bn in 1998, representing 0.2% of GDP. Prior to 1998, real total fee revenue ranged between £0.9bn and £1.1bn. Figure 25 illustrates.

<sup>86</sup> Source: Architects Performance 1999, Mirza and Nacey Research.

<sup>87</sup> At current market prices.

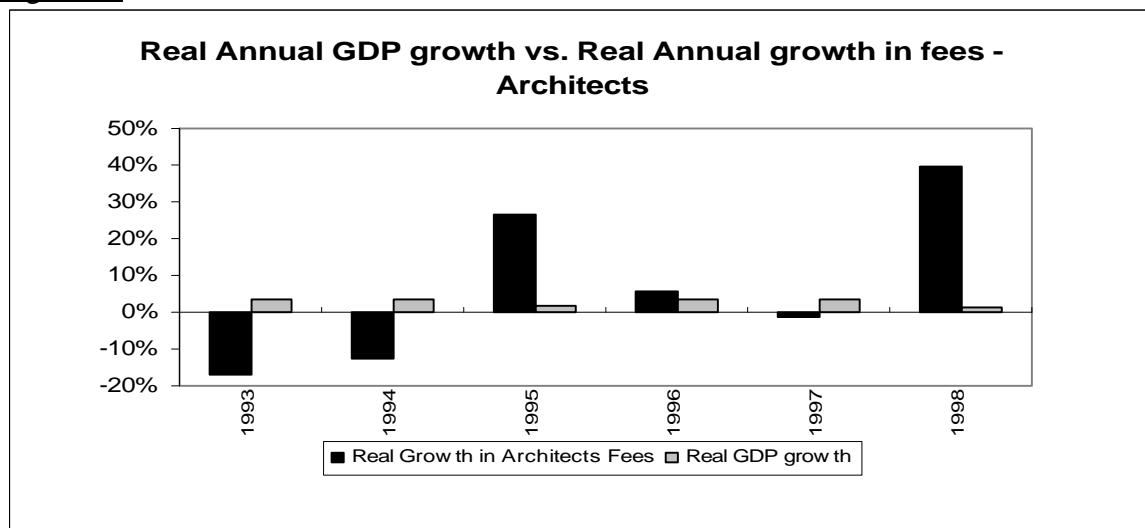
Figure 25



Source: Mirza & Nacey Research, Architects Performance 1999 and Economic Trends Annual Supplement 1999.

361. Real annual growth in fees has fluctuated significantly from year to year (see Figure 26). From 1993 to 1998, real growth in fees ranged from -17% to +39%, compared with a range of 0.3% to 3.4% for real GDP<sup>88</sup>. This high degree of variability in fee levels – including the 38% growth in real fees in 1998<sup>89</sup> – may be related to the degree of specialisation that exists within the profession (see Figure 24 above). Alternatively, it could reflect poor quality data.

Figure 26



Source: Mirza & Nacey Research, Architects Performance 1999 and Economic Trends Annual Supplement 1999.

<sup>88</sup> Source: Architects Performance 1999, Mirza and Nacey Research and Economic Trends Annual Supplement 1999.

<sup>89</sup> Source: Architects Performance 1999, Mirza and Nacey Research.

362. We have not been able to find any data on the profitability of architecture firms.

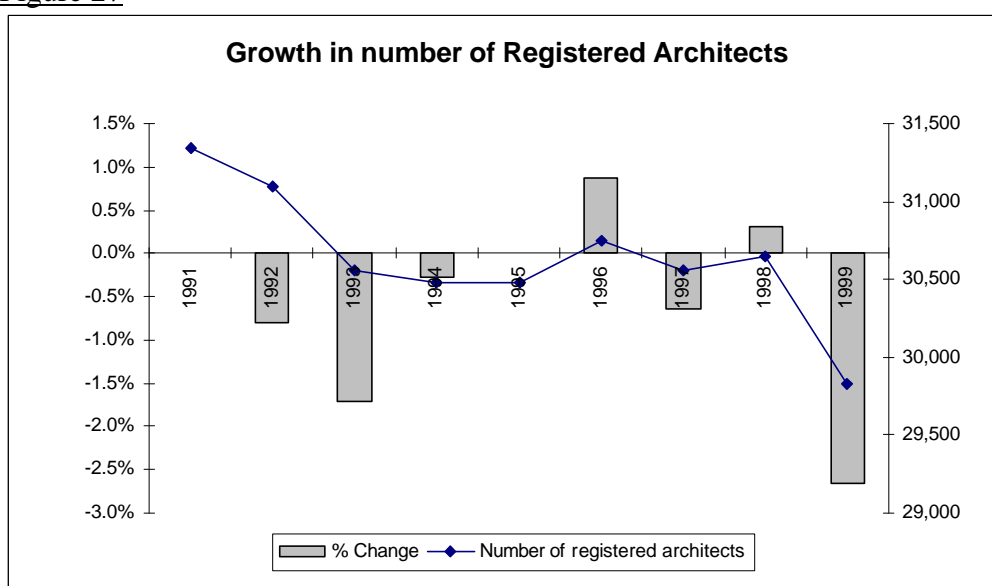
**Market structure**

363. We have not been able to find any data on the market shares of individual architect firms. Anecdotal evidence (e.g. from our interview with RIBA) suggests that there are a few large architecture firms and great many very small firms.

**Numbers of architects and earnings**

364. Figure 27 illustrates a clear decline in the number of Registered Architects over the period 1991 to 1999. In 1991 there were 31,346 registered architects in the UK, but by 1999 there were 29,829 - a contraction in the profession of nearly 5%.

Figure 27



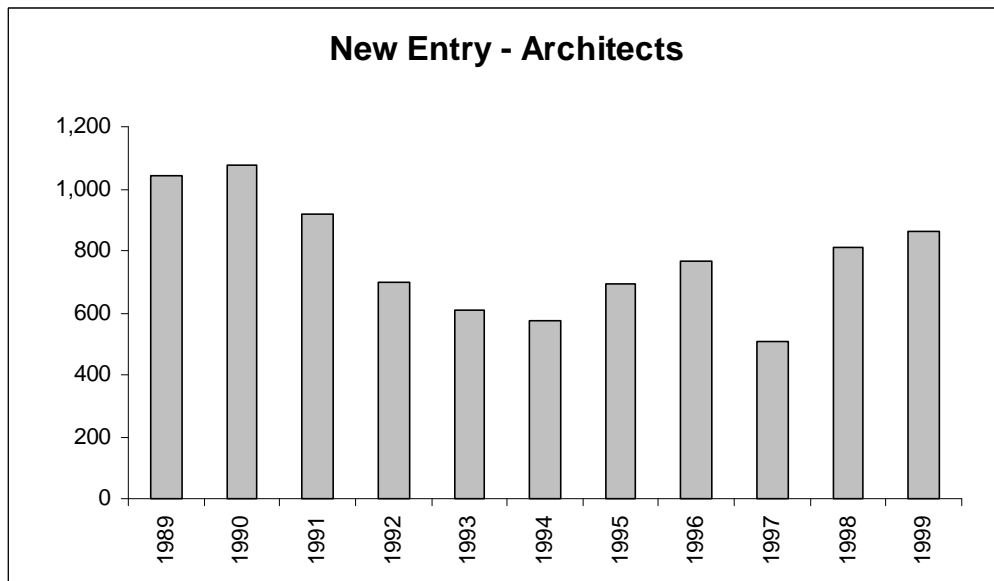
Source: The Architects Registration Board

365. Figure 27 also shows how the year on year change in total registrations has been generally negative, with the largest decrease (-2.7%) occurring in 1999<sup>90</sup>. Annual new entry into the profession has also fallen from 1,040 in 1989 to 844 in 1999 (see Figure 28). At first glance it is not clear why numbers have declined. One possible cause is contracting demand for architectural services. Another possible cause is that there have been restrictions on new entry, perhaps in combination with, or independently of, a decline in demand. The Architects Registration Board believed that an increase in registration fee in 1999, from £30 to £55 per annum, might have prompted some older and retired architects to remove their names from the register, but we are not persuaded that this explains the whole of the decrease in numbers: the absolute amount of the fee is, after all, not great.

<sup>90</sup> Source: Architects Registration Board Annual Report 1999.



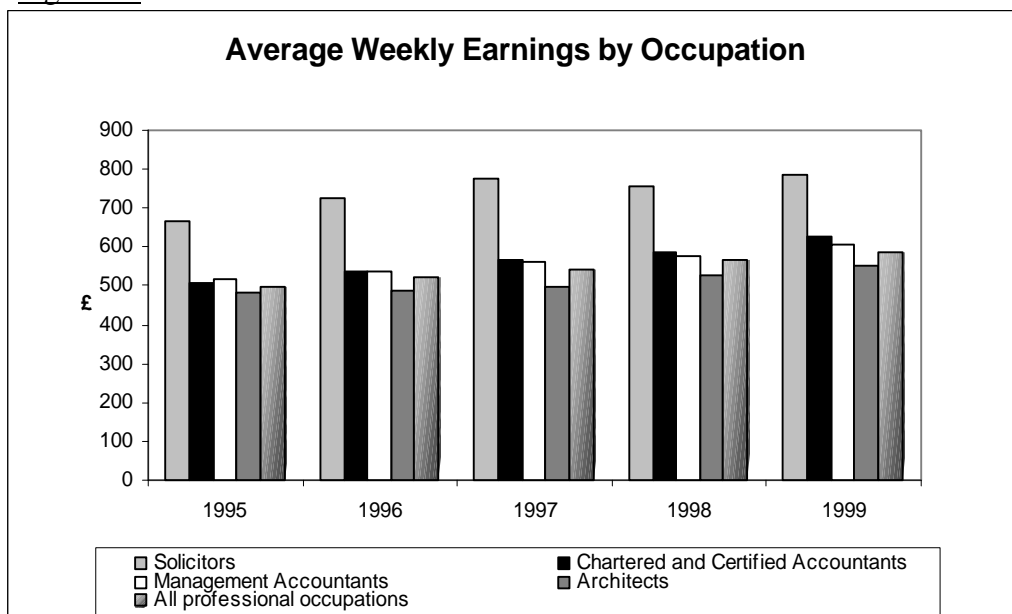
Figure 28



Source: The Architects Registration Board

366. Although there is no data available on firm profitability, the level of earnings for both salaried architects and principals in partnership does not suggest a deliberate entry restriction strategy. Architects have the lowest average weekly gross earnings of the three professions under review: £554 in 1999 as compared to £624 for chartered accountants and £788 for solicitors (see Figure 29).

Figure 29

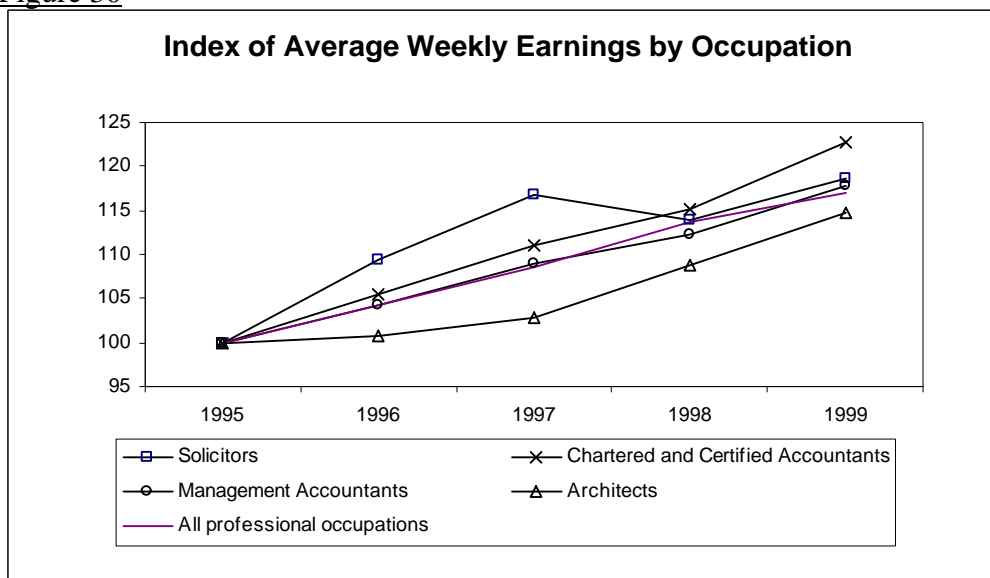


Source: The New Earnings Survey 1995-99

367. Moreover, the growth in architects' earnings has been lower than for the other two professions. From 1995 to 1999 (the period for which data was available), the

index of average weekly earnings for architects rose to 114.8 (from a base of 100 in 1995)<sup>91</sup> compared with 118.6 for Solicitors and 122.6 for Chartered Accountants (see Figure 30).

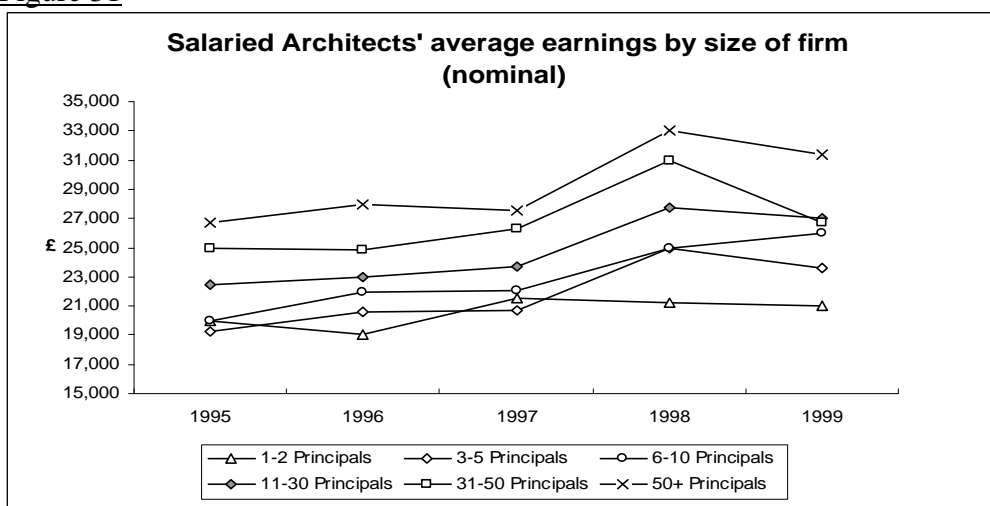
**Figure 30**



Source: The New Earnings Survey 1995-99

368. In general, salaries increase with the size of the firm and with the number of principals. Figure 31 and Figure 32 illustrate the trend in average earnings over the period 1995 to 1999 for salaried architects and principals in partnership respectively.

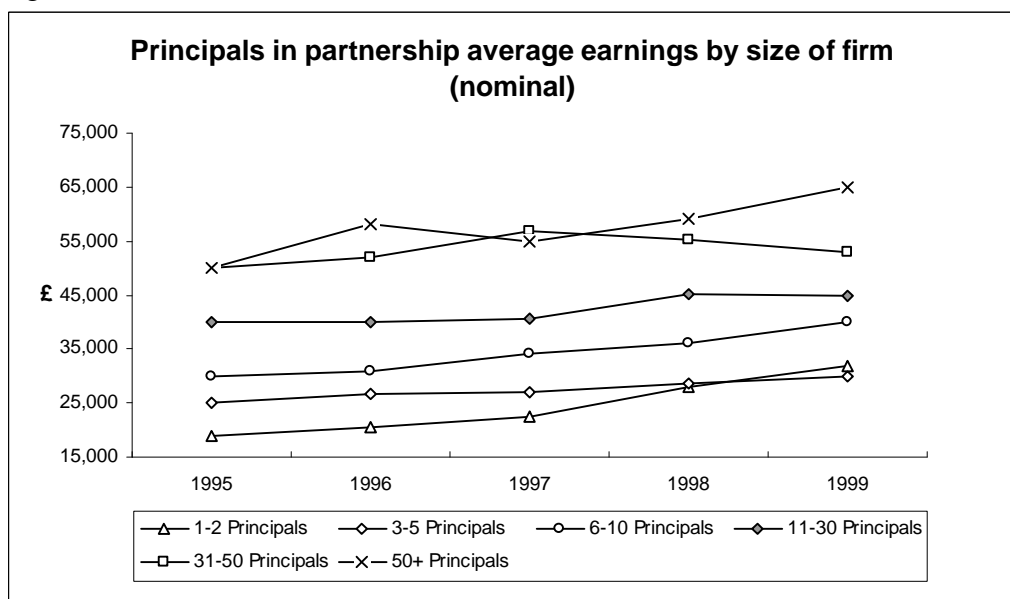
**Figure 31**



Source: Mirza & Nacey Research, Architects Performance 1999

<sup>91</sup> Source: The New Earnings Survey 1995-99.

Figure 32



Source: Mirza & Nacey Research, Architects Performance 1999

### **Regulation of the architecture profession**

369. The Architects' Registration Board (ARB) and The Royal Institute of British Architects (RIBA) are the most significant players in the regulation of the architecture profession. We summarise below the role, powers and structure of these two bodies, and the other architecture bodies with a regulatory remit.

#### **The Architects' Registration Board (ARB)**

370. The Architects' Registration Board (previously the Architects Registration Council or ARCUK) was created by the Architects Act 1997 and given defined regulatory powers in relation to consumer protection and the public interest. The ARB was also given the status of UK competent authority for Europe with a specific mandate to implement the 1985 European Commission Architects' Directive - which specifies the core areas and duration of study required for European recognition of a qualification in architecture (see below).

371. The ARB is sponsored by the Department for the Environment, Transport and the Regions (DETR), and all appointments to the ARB are made by the Privy Council in conjunction with the DETR and the profession itself. As such, the ARB is an independent statutory body with wide-ranging powers. These are used so as to: '*Protect the Consumer and safeguard the reputation of Architects*' (ARB Annual Report, 1999).

372. The board of the ARB has a strong customer focus - 8 of its 15 members have a consumer rather than professional architecture background. The ARB's primary statutory duties are as follows:

- To enforce the terms of the Architects Act 1997, and ‘*to maintain the Register of Architects in which there shall be entered the name of every person entitled to be registered under this Act*’ (Article 3(1) of the Architects Act).
- To oversee the validation process for courses of architecture in the universities, thus ensuring that high standards are maintained.
- To implement the EEC Council Directive of 10 June 1985 on the mutual recognition of diplomas, including measures to facilitate the effective exercise of the right of establishment and freedom to provide services. The ARB thus has the statutory duty to assess overseas architecture qualifications, and to ensure that these meet the required standard.
- To maintain consumer protection and quality of professional standards.

*Code of conduct and disciplinary powers*

373. The ARB has recently (December 1999) published a new version of the Code of Conduct. The Code is concerned with the protection of the public interest, as well as setting professional standards.

374. The ARB has significant powers to enable it to carry out its statutory functions effectively. It has the power to fine, suspend or remove an architect from the register if he or she is found guilty of malpractice. The ARB can also prosecute unregistered individuals attempting to present themselves as architects. This disciplinary power is perceived by the ARB as fundamental to its aim of protecting consumers. In 1999, the ARB received 850 complaints from the public on the activities of architects and on title abuse. Prosecutions can follow from these complaints, but can only be successfully undertaken when evidence to the criminal standard of proof is available.

**The Royal Institute of British Architects (RIBA)**

375. RIBA is the main professional body for Architects in the UK, with approximately 32,000 members. Membership is not mandatory, but around 75% of those qualified and entitled to join (i.e. all registered architects), choose to do so. It is a Chartered institution and a registered charity. RIBA’s stated objective is: ‘*The advancement of architecture and the promotion of the acquirement of the knowledge of the arts and sciences connected therewith*’ (RIBA Web-site).

376. RIBA was granted a Charter in 1837 and Supplemental Charters were granted in 1887, 1909 and 1925. These Supplemental Charters have all now been revoked and replaced by the Supplemental Charter of 1971. All members of RIBA may use the title ‘Chartered Architect’. The role of the RIBA is governed by this Charter and by the subsequent Byelaws.

377. RIBA has no statutory powers or responsibilities. Its main professional responsibilities are to promote architecture and to advance the expertise, education and interests of the profession.

**The Royal Society of Architects in Wales (RSAW)**

378. RSAW operates in a similar way to RIBA.

**The British Institute of Architectural Technologists (BIAT)**

379. The British Institute of Architectural Technologists (BIAT) is the professional institute representing over 6,000 professionals working and studying in the field of Architectural Technology in the UK and overseas. As such, BIAT has become internationally recognised as the qualifying body for Architectural Technologists by creating a standard of competence for corporate membership. It has neither a charter nor protection by statute

380. BIAT's primary aims are to establish proper standards of competence for the profession and to promote the interests of its members. Architectural Technologists practice the "science of architecture" and are specialists in building design and construction, concerned primarily with the technical performance of buildings.

381. Members are regulated through the BIAT Code of Conduct, which requires the proper and ethical conduct of business. BIAT has disciplinary procedures for dealing with members who infringe the Code.

**The Union Internationale des Architectes (UIA)**

382. The UIA represents architecture professional bodies in over 10 different countries. It is responsible for the Accord on Recommended International Standards of Professionalism in Architectural Practice

**Assessment of individual restrictions in the architecture profession**

**Direct entry restrictions**

*Entry criteria and reservation of title*

383. Any applicant for registration by the ARB is entitled to be registered and thereby use the title "Architect" providing the applicant is qualified to the requisite level. Those failing to meet these standards are prohibited from using the title. Before stipulating the necessary qualifications the ARB has a statutory duty to consult those bodies representing architects which are incorporated by royal charter, namely the Royal Institute of British Architects (RIBA).

384. ARB and RIBA work together to validate any course and exam that they consider achieves the standards necessary to prepare students for practice as an Architect. The ARB is responsible for the validation of registration, and RIBA for corporate membership of the institute. All validated courses are defined in terms of Parts 1, 2 and 3 of the training process. Part 1 consists of a degree in architecture, Part 2 is monitored training with a registered Architect, and Part 3 consists of further training in areas such as legislation and urban planning. Students who have completed Parts 1, 2 and 3 of validated courses become eligible to practice as an

Architect, and to become a member of RIBA (although registration and practice under the title “Architect” does not require membership of RIBA).

385. The Architects Act 1997 sets out the criteria for membership of the ARB as follows:

- *[A member] ‘holds such qualifications and has gained such practical experience as may be prescribed’ (4-1-a of the Architects Act 1997); or,*
- *‘Has a standard of competence which, in the opinion of the board, is equivalent to that demonstrated by satisfying paragraph a’.*

386. In effect, when determining the standards required for registration, ARB are bound to refer to Article 3 of the EC Architects’ Directive. This defines the statutory framework for the range of skills and knowledge perceived to be within the required competence of an architect. Currently, the training requirements of other professional bodies such as BIAT (see below) do not meet these criteria. Article 3 of the EEC Directive of 10 June 1985 states that: “...*studies shall be balanced between the theoretical and practical aspects of architectural training and shall ensure the acquisition of:*

- *An ability to create architectural designs that satisfy both aesthetic and technical requirements.*
- *An adequate knowledge of the history and theories of architecture and the related arts, technologies and human sciences.*
- *A knowledge of the fine arts as an influence on the quality of architectural design.*
- *An adequate knowledge of urban design, planning and the skills involved in the planning process.*
- *An understanding of the relationship between people and buildings, and between buildings and their environment, and of the need to relate buildings and the spaces between them to human needs and scale.*
- *An understanding of the profession of architecture and the role of the architect in society, in particular in preparing briefs that take account of social factors.*
- *An understanding of the methods of investigation and preparation of the brief for a design project.*
- *An understanding of the structural design, constructional and engineering problems associated with building design.*
- *An adequate knowledge of the physical problems and technologies and of the function of buildings so as to provide them with internal conditions of comfort and protection against the climate.*
- *The necessary design skills to meet building users’ requirements within the constraints imposed by cost factors and building regulations.*
- *An adequate knowledge of the industries, organisations, regulations and procedures involved in translating design concepts into buildings and integrating plans into overall planning.*

387. The validation process is open to any educational institution and is carried out by the validation panel, which consists of ARB and RIBA representatives in approximately equal proportions. The ARB has the power to validate any course as long as it meets all of the EC Directive criteria listed above.
388. However, as previously mentioned, RIBA plays an integral role in the validation of architectural courses alongside the ARB. Thus RIBA now recognises courses and examinations for the purpose of corporate membership of the institution. RIBA has developed an outline syllabus, and all courses seeking validation are required to meet or exceed these requirements. This syllabus existed long before the formation of the ARB – and the ARB has chosen to use this outline syllabus in conjunction with the EEC Directive in its validation process.
389. In addition, RIBA helped draft the content of Articles 3 and 4 of the EC Architects Directive, and thus the criteria of the outline syllabus are fully compatible with the Directive. Any validated course will automatically satisfy the criteria necessary for European recognition stated in the Directive.
390. These requirements are designed to ensure that those entering the profession have the necessary competence. Members are regulated through the RIBA Architects Code – *Standards of Conduct and Practice*.
391. The minimum length of training required to qualify for registration with ARB is effectively seven years. This derives from the training criteria prescribed by the ARB and the EU Directive. RIBA also specify training requirements that fulfil the ARB criteria, but these are not necessary for an individual to practice architecture.

*Qualification as an architectural technologist*

392. To become a member of BIAT, an individual must fulfil the BIAT training criteria. These criteria usually consist of a 3 year degree in Architectural Technology, followed by 3 further years gaining supervised practical experience. BIAT have a list of validated courses in the UK, and also a list of equivalent foreign qualifications. However, the BIAT training procedure does not fulfil the criteria set out by the ARB validation process. This is because its current training process does not cover all of the 11 criteria outlined by the EEC Directive.

*Effect of qualification requirements*

393. The main justification advanced by defenders of the current level of entry restrictions is that the prescribed training is necessary to maintain professional standards and to protect the public from poor quality work. The DETR argue that the current training requirements are not excessive, and are in the interests of the public. They also maintain that the current requirements are important for the mutual recognition of diplomas across Europe.

394. RIBA agree. They see the training programme outlined by the ARB and RIBA as necessary to ensure competence. RIBA says it is committed to the '*advancement of civil architecture and the arts and sciences therewith*' (RIBA web-site). RIBA also emphasise the need to maintain the professional standards of their members. The international average training period (formal qualification plus experience) is 6.9 years (see Chapter III).
395. Our research shows that there has been a fall of some 5% in the number of registered architects since 1991 (see Figure 27). This decline may suggest that entry requirements are acting as a barrier to entry. However, as we recorded in paragraph 365, ARB argue that the reason for this fall in numbers is the sharp increase in registration fees in 1999 (from £30 to £55), causing older and semi-retired architects to withdraw their registration. Data on the numbers withdrawing their registration appear to confirm this view, certainly for 1999, when there were 1,112 resignations compared to an average number of resignations of 397 in the 11 preceding years. Other data, for example the stability in the number of new admissions (see Figure 28 above) and the low relative level of earnings in the profession, do not suggest a strategy of deliberate entry restriction.
396. Currently the ARB and RIBA training programmes are the only ones that meet the EEC directive criteria. BIAT courses do not. Consumers, however, are free to choose between registered Architects and other providers of architectural services such as technologists or structural engineers. Provided that consumers are aware that they have this choice and can therefore purchase services that best meet their needs, there does not appear to be an issue of competition. Issues of consumer awareness are discussed more fully in the next section.

**Indirect entry restrictions: Demarcation**

397. Under the Architects' Act 1997 (Section 4 - provisions relating to registration, and Part IV. s20 – use of the title 'Architect') the title "Architect" is reserved to those registered with the ARB (see above). These provisions are also contained in Article 3 of the European Commission Architects Directive 1985 (which defines the eleven criteria that need to be fulfilled in order to be able to use the title "Architect". See above.).
398. The main justification advanced for the restriction of the title is that it acts as an effective way of protecting an often ill-informed public from those claiming to be architects but not having the relevant qualifications. It therefore acts as a "quality mark" for architectural services which consumers can use to counter any informational asymmetries that may exist between the client and the professional. Reservation of the title also facilitates the maintenance of professional standards by requiring that all architects complete the prescribed educational training.
399. The statutory reservation of the title 'Architect', when reinforced by third party perceptions, may, however, inhibit competition between registered Architects and those equally well qualified to carry out certain types of work, such as



Architectural Technologists. BIAT, for instance, claims that some large private and public institutions – [details omitted] – tend to restrict competition for certain commissions to registered architects and/or RIBA members even where the project could be equally well undertaken by a BIAT member.

400. BIAT claim that the statutory protection of the title ‘Architect’ is unfair and ineffective. They argue that the fundamental difference between Architects and architectural technologists is the nature of qualification process: architects’ training is design-based whereas technologists’ training is science-based. A BIAT member generally completes a similar length of training to an architect, i.e. 3-year degree in Architectural Technology, followed by a years work experience and two years in monitored training position (i.e. 6 years in total). BIAT feel that this qualification process is on par with that of architects in terms of stringency and difficulty.
401. The problem, as BIAT sees it, is that clients are not generally aware of the distinctions between architects and technologists and this places BIAT members at a competitive disadvantage. To limit the effect of this information asymmetry and the ignorance surrounding the term ‘technologist’, BIAT members would like to be able to adopt the title ‘Technical Architects’ (currently prohibited under the Architects’ Act 1997). More generally, they would like to see a “level playing field” and suggest that: *‘The sensible way forward would be for the Architects Act to be extended to cover all professions within architecture, e.g. design architects, landscape architects and technical architects’* (interview with BIAT). By removing the special protection afforded to “architects”, BIAT believe there would be a positive impact on competition as technologists would be able to compete on equal terms for all commissions.
402. RIBA, however, suggest that the key difference between BIAT members and their own members is one of competence rather than merely a greater emphasis in their training on science rather than design. In RIBA’s view, BIAT members do not, in general, possess the creative design skills of a RIBA member - although they concede that the level of technical skills may be similar.
403. DETR support RIBA’s stance, although they admit that a technologist may be an alternative for smaller, non-complex jobs such as domestic house extensions. They agree with BIAT on one point, however: the degree of client ignorance over the distinctions between architects and technologists. Unlike BIAT, however, they feel that the existing protection of title helps counteract this information asymmetry. DETR also claim that quality of services would fall if the protection of title were removed.
404. Although there is reservation of title, there is no strict demarcation of services: clients are free to hire an Architect, a technologist, a structural engineer or none of these if they so wish. Consequently, in our view, the intensity of competition

depends on the extent to which consumers' are able to make informed choices between these alternative providers of architectural services.

405. A key issue, therefore, is whether or not the consumer is sufficiently well informed to choose between the competing architectural practitioners. We believe that the reservation of the title "Architect" may help rather than hinder in this respect. It provides some degree of information to consumers seeking advice on the best design to meet their requirements, as opposed to re-assurance that the building will be structurally sound – but leaves other options open. We think that allowing BIAT members to call themselves "technical architects" would confuse consumers further.
406. We are re-inforced in this conclusion by the fact that there appear to be sufficient numbers of competing architects to ensure that profits and salaries are not excessive (see above).
407. We have two remaining concerns, however. First, confirmation is needed that the registration requirements set out in the EU Directive (see above) are objective, fair and non-discriminatory – particularly as some of the criteria appear to be quite vague in their implications. In particular, it seems to us that it should be possible for a BIAT member to become a registered architect without having to complete the full seven-year training applied to those with no architectural training. It should be possible for BIAT members to "convert" to registered architect status by studying those topics they have not already mastered.
408. Second, our evidence suggests that – despite the reservation of title - there remains a worrying degree of consumer ignorance. Competition in the market should increase if this informational asymmetry was addressed. It would be desirable if the various professional bodies took action to provide clients with better information on the different abilities and roles of an architect, architectural technologist, building engineer, etc. (for example, by jointly publishing a leaflet).

### **Restrictions on permitted business structures**

409. RIBA's Charter and Bylaws contain a rule whereby, for a practice to be recognised as an architectural practice, 50% of its staff must be registered architects (although not necessarily RIBA members). RIBA also require that 80% of the architects in a practice must be members of RIBA for that practice to be listed in the RIBA directory.
410. RIBA justify the 50% rule on the grounds that it is in the interests of both the consumer and the architect that any business claiming to be an architecture firm should be controlled by registered architects. This rule is designed to minimise the impact of possible conflicts of interest. The 80% rule is designed to protect RIBA's position as a professional institute, and to maintain professional standards.

411. The concern in relation to competition is that the 50% rule may inhibit the formation of multi-disciplinary partnerships (MDPs), and therefore act as a barrier to entry for a potential new source of competition. It may also prevent the realisation of potential economies of scale and scope. However, there is no explicit rule prohibiting the formation of particular business structures. With regard to the 80% rule, BIAT claim that an MDP or firm employing less than the stipulated proportion of architects, would be at a disadvantage in terms of marketing because they could not promote themselves in the RIBA Directory even if in absolute terms there were significant numbers of registered architects perfectly capable of carrying out all types of service.
412. We have found mixed evidence that these restrictions limit the creation of MDPs. On the one hand, RIBA and DETR claim that MDPs are common in the architecture profession, and that neither the 50% or 80% rules have had a significant impact on their formation. BIAT, however, disagrees and highlights the marketing impact described above. Our evidence suggests that a listing in the RIBA Directory may indeed be an important source of new work.
413. On balance, our view is that these restrictions are unlikely to have a significant impact on competition. The evidence suggests that MDPs and other business structures are fairly widespread, typically involving partnerships of architects, technologists, surveyors and chartered builders.
414. There is some evidence to suggest that certain organisations discriminate against non-RIBA registered practices (in this regard BIAT cite the Church Commissioners, English Heritage and the Sports Council) thereby inhibiting competition. However, there is nothing to stop a practice which feels itself disadvantaged from asking more of its registered architects to join RIBA (which they are all free to do), until it reaches the point where it is eligible for inclusion in the RIBA directory.<sup>92</sup>

## **Conduct restrictions**

### *Fee guidance*

415. RIBA provides guidance on fees to members and the public through recommended fee scales. These fee scales are based on survey data from the 1960s, adjusted according to a tender price index. The tender price index in turn is based on a quarterly survey conducted on behalf of the Royal Institute of Chartered Surveyors (RICS). If there is a significant change in the index, RIBA shift the fee scale curves accordingly. The curves can be shifted in or out to reflect market conditions, but their shape is not altered. The fee scales originate with RIBA and are described in their 'Guidance for Clients on Fees', the RIBA Code of Conduct and a RIBA leaflet entitled 'A Clients guide for engaging an Architect'. ARB do not make any mention of fee scales in their code of conduct.

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<sup>92</sup> It should be noted that this issue is unaffected by the distinction between architects and architectural technologists. The RIBA rule concerns only the percentage of the *architects* in the firm who are RIBA members.

416. RIBA claim that the fee scales provide essential cost planning and project budgeting information for both the architect and the client. A client who is ignorant as to what a reasonable charge should be (which RIBA says is often the case) can thus accurately forecast the cost of the service. This assists budgeting, and may help prevent disputes arising over fee levels once the project is completed. RIBA see no realistic alternative to fee scales, believing that historical surveys of actual fees charged would amount to the same thing. RIBA emphasises that these scales are meant to act only as an indicator and as a basis for negotiation. RIBA also emphasises that the scales can be shifted in response to a change in the Tender Price Index (although such a shift has only occurred once in recent times).
417. BIAT also recognises a significant demand from clients for some form of guidance on fees. Accordingly, BIAT would also like to adopt a fee scale – but would be prohibited from doing so by the Office of Fair Trading (OFT)<sup>93</sup>. They feel that it is unfair that RIBA are allowed to have fee scales when BIAT are not, and that the absence of a fee scale reinforces a third party perception that technologists are inferior to architects. BIAT claim, for example, that local authorities tend to pay lower fees to technologists than architects for comparable work on grant- funded projects. According to BIAT, their members sometimes refer clients to RIBA scales when asked for some guidance on fees. BIAT concede, however, that historical surveys of actual fees charged could provide an alternative to fee scales so long as they were introduced uniformly across the industry
418. There is little doubt that *mandatory* fee scales can distort or even eliminate price competition. However, even fee guidance can restrict competition because their circulation among the suppliers in a market may provide a lead on prices, which firms will tend to follow, irrespective of their own costs. In this way, fee guidance encourages tacit collusion<sup>94</sup> (and this may include non-RIBA members to the extent that they use the RIBA fee curves). The effect on competition will depend on the level and shape of the fee curves themselves relative to the prices determined by competitive market forces.
419. The same objection does not apply to historical information on prices because such information does not provide a lead in setting this year's prices. Even this may dampen price competition somewhat, in that low-cost firms are able to see that they need not charge at cost, given that their competitors are, on average, charging more.

<sup>93</sup> OFT Guideline 408, para 3.3.

<sup>94</sup> This approach is apparent in a number of decisions of the European Commission and Court of Justice, eg Case 45/85 Verband der Sachversicherer e.V. v Commission and IV/34.983-FENEX. It is also to be seen in the MMC report on Private Medical Insurance and in the decision of the French Conseil de La Concurrence in respect of architects.

420. Our evidence suggests that RIBA’s current fee scales are not related to market forces, and thus may be inhibiting price competition to some degree. However, the significance of this impact is questionable because of the competitiveness of at least certain segments of the market which in practice forces many architects to abandon fee scales. Nevertheless, evidence from other countries (notably Australia) suggests that other methods of informing clients about expected fees, in ways that reflect current local market conditions could be used to satisfy client demand (RIBA’s fee scales do not allow for local variations). Examples might include regular historic surveys of actual charges, or estimates based on cost. It is also possible that greater use of fee advertising would be a more efficient way of informing clients (see below). Both DETR and BIAT appeared willing to consider such alternatives.

### **Advertising restrictions**

421. RIBA, BIAT and ARB all produce guidelines on the use of advertising. RIBA and ARB justify these restriction on grounds that they protect against conflicts of interest. The RIBA Code requires a member to *‘not give or accept any commissions or gifts or other inducement to show favour to any person or body, nor allow his name to be used in advertising any service or product associated with the construction industry’*. The ARB Code requires that registered architects should not make untruthful or misleading statements about the services they offer. Advertisements should conform to general advertising codes: the BCAP, ITC and Radio Codes of Advertising. BIAT’s Code of Conduct places no restrictions, other than general advertising codes, on their members.
422. Restrictions on advertising can inhibit competition by preventing consumers from receiving valuable information that would help them make a purchase that best suits their needs. Restrictions on advertising may also reduce competition by preventing new entrants without an existing reputation from informing potential clients of their existence and skills.
423. In our assessment, however, advertising in the architecture profession is not restricted to a significant extent over and above restatements of general regulations. There are no restrictions on fee or comparative advertising, for example. Moreover, advertising is not widespread in architecture because of the complex nature of the service and the importance of referrals and recommendations in winning work. BIAT, DETR and RIBA all contend that recommendations, referrals and previous projects are they key sources of new work, together with competitive tendering for larger projects. Some 60% of architectural work is repeat business according to RIBA. Advertising tends to be limited to the Yellow Pages and to listings on the RIBA or BIAT directories. This limited use of advertising as a competitive weapon may possibly be due to a simple lack of commercial acumen.

## VIII Restrictions in the insolvency practitioners profession

424. In the available time, we were unable to fully investigate the nature of restrictions imposed on the Insolvency Practitioner profession. In the paragraphs that follow, therefore, we merely note some of the issues raised during our research.
425. There are about 1,800 Insolvency Practitioners (IPs) in the UK, and about 1,200 of these take appointments (one office holder takes each appointment). There are several areas of work undertaken by IPs – each constituting a formal insolvency procedure.
426. One of these procedures is the administration of receivership. Administrative receivers are appointed by creditors secured by fixed and floating charges over the company's assets, typically banks. At a glance it might appear that the banks have a clear incentive to get the best deal from their IP. Indeed, this would typically be the case if the value of the assets of the firm were less than the debt to the bank. However, if the assets of the company exceed their debt to the bank, the bank's incentive to minimise the charge from the IP is greatly reduced, since the bank can only recover 100% of what it is owed. This means that other less senior debtors' interests may not effect the choice of IP.<sup>95</sup> This may be a cause of a lack of competition for insolvency services, but it is not caused by a restriction. It appears to be the nature of the service at fault.
427. Liquidation is another formal insolvency procedure. There will be between 13,000-14,000 of these this year, of which 5,000 will be compulsory.
428. Insolvency is regulated in the terms laid out in the Insolvency Act 1986. Prior to 1987 there was little formal regulation, and the only people legally prevented from acting as Insolvency Practitioners were bankrupts and people of unsound mind. Entry to Insolvency is now far more restricted.
429. There are a number of recognised professional bodies for insolvency. They are the ICAEW<sup>96</sup>, ICAS<sup>97</sup>, ICAI<sup>98</sup>, ACCA<sup>99</sup>, Law Society, Law Society of Scotland, and the Insolvency Practitioners Association (IPA). The DTI also licenses insolvency practitioners directly. There are three classes of people eligible to sit the Joint Insolvency Examination: a qualified solicitor, a qualified chartered accountant or certified accountant, or a student member of the IPA who has passed the IPA's entry level examinations. The Joint Insolvency Examination Board requires all candidates to have two years' insolvency experience prior to sitting the exam.<sup>100</sup>
430. Under the provisions of the Insolvency Act 1986 only an IP may hold office in any formal insolvency procedure (such as administration of receivership or liquidation). This includes formal individual voluntary arrangements (IVAs)

<sup>95</sup> Interview of The Insolvency Service, 9/11/00

<sup>96</sup> Institute of Chartered Accountants in England and Wales

<sup>97</sup> Institute of Chartered Accountants in Scotland

<sup>98</sup> Institute of Chartered Accountants in Ireland

<sup>99</sup> Association of Chartered Certified Accountants

<sup>100</sup> Response of The Insolvency Practitioners Association

under part II of the Insolvency Act 1986, or Part II of the Insolvency Order. There are concerns expressed by the Insolvency Service that due to the increasing demand for IVAs there may be a bottleneck due to the relatively small numbers of IPs, and that this may be restricting competition and forcing up prices. Although a solicitor<sup>101</sup> or in fact any individual can set up an *informal* individual voluntary arrangements (IVAs), the Insolvency Service suggested that this pro-competitive impact is weakened because of the low sophistication of people purchasing IVAs<sup>102</sup> (many consumers will tend to rely solely on formal IVAs).

431. IPs are restricted in accepting payment for referrals. Their ethical guidance is as follows: *"The special nature of insolvency appointments makes the payment or offer of any commission for, or the furnishing of any valuable consideration towards, the introduction of insolvency appointments inappropriate."*<sup>103</sup>
432. The one exception to that is an arrangement between a practitioner and a bona fide employee whereby the whole or part of the employee's remuneration is based on commission for introductions. Furthermore, in addition to any statutory consequences which it may incur, solicitation for insolvency work amounting to that which a reasonable person would regard as harassment may render a practitioner liable to be considered for regulatory and/or disciplinary action. The Insolvency Rules 1986 provide that remuneration may be disallowed to a liquidator or trustee whose appointment has been procured by improper solicitation.<sup>104</sup>

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<sup>101</sup> Here meaning an ordinary qualified solicitor rather than one who has also passed the insolvency examination.

<sup>102</sup> Interview of The Insolvency Service, 9/11/00

<sup>103</sup> Response of The Insolvency Service

<sup>104</sup> Response of The Insolvency Service

## IX Conclusions

433. Chapters II and III of this report discussed in theoretical terms the trade-off that is necessary in evaluating regulation of the professions, a trade-off between informational and similar benefits to clients and adverse effects on competition. Chapters IV to VII considered evidence of the competition effects of particular restrictions in both branches of the law, accountancy and architecture. In this chapter, we summarise our main findings.
434. Our first conclusion is that the necessary balance between benefits and adverse effects is best struck by the competition authorities, since they have considerable experience of striking it in other sectors of the economy. Under the Competition Act (CA) 1998, the OFT (and the Competition Commission - CC - as an appeal body) has to consider whether agreements which appreciably restrict competition might nevertheless be justified on grounds of improved production, distribution or economic progress. Under the Fair Trading Act 1973, the CC is required to balance competition and all other relevant factors to arrive at a judgement on where the public interest lies.
435. We do not believe that the exercise of striking a balance is significantly different in the professions from that in other sectors. Accordingly, we make an overall recommendation that the Competition Act 1998 should be extended to cover the professions in full. If this is done, the complex trade-offs described in our report can be addressed on a case-by-case basis to ensure that the regulation of the professions best serves the public interest.
436. Turning to the specific restrictions we have investigated, we would again stress that our remit was to assess their effect on competition, rather than to carry out a full public-interest assessment. We see the latter assessment as a later stage in the process and we set out in Chapter III a suitable economic methodology for carrying it out.
437. We have classified restrictions under three headings: direct entry, indirect entry and conduct. Direct entry restrictions include qualification and experience criteria and the definition and protection of professional titles. Indirect entry restrictions embrace the demarcation of services (the definition of specific types of work that a regulated professional can do) and constraints on the ownership, management and control of professional firms. Codes of conduct, technical standards (usually supported by disciplinary procedures), fee setting and restrictions on advertising / marketing are all examples of conduct restrictions.
438. On direct entry restrictions, we have reached the same conclusion across all the professions we have looked at: we see no evidence of a deliberate attempt by professional bodies to restrict entry in order to increase the average incomes of those in the profession.



439. We have, however, found evidence that indirect entry restrictions and rules on permitted conduct are restricting or distorting competition, to a greater or lesser extent, across all four professional groups. We now summarise our findings profession by profession.

**Law: solicitors**

440. In five areas, we believe that demarcation continues to restrict competition. In the case of the first three, action has already been taken to reduce demarcation barriers, but it has not yet, in our view been fully effective.

*(i) Advocacy*

Third-party perceptions may be limiting the number of solicitor-advocates competing in this market. Numbers of solicitor-advocates should be monitored following the recent AJA 1999 reforms in this area.

*(ii) Conveyancing*

Our evidence suggests that competition in the conveyancing market between solicitors and other providers of these services remains inhibited. The CLSA (ss34-52) has provided for further competition to be introduced by means of an exemption from s22 of the Solicitors' Act for 'authorised practitioners' (e.g. banks and building societies employing qualified staff such as solicitors). The CLSA reforms should be fully implemented alongside action on advertising and fee guidance (see paragraph 442 below).

*(iii) Probate*

Our evidence suggests that competition in the probate market between solicitors and other providers of these services is restricted. The CLSA (s54) provides for the right to perform probate work to be extended to other potential competitors such as banks, building societies and insurance companies. This scheme should be brought into force alongside action on advertising and fee guidance (paragraph 442 below).

*(iv) Restrictions on employed solicitors acting for third parties*

We believe that these restrictions reduce competition in certain markets. For example, legal expense insurers cannot handle a claim for a client if the value is over £5,000.

*(v) Legal professional privilege*

Where the client is concerned that advice given should be privileged, only lawyers are able to compete. We believe that this restricts competition in areas such as tax advice.

441. We see one major indirect entry restriction arising from constraints on the structure of law firms, the prohibition of multi-disciplinary partnerships.

*Multi-disciplinary partnerships*

Rules that prevent the establishment of MDPs are anti-competitive in that there are professionals who believe they could operate or compete more effectively in that form. Examples include fully integrated accountancy/legal practices, property services (e.g. surveyors, estate agents and solicitors), financial services (accountants, financial advisers and solicitors) and family law (solicitors and mediators).

442. We believe that three rules on conduct are restricting competition.

(i) *Advertising restrictions*

Cold-calling and comparative fee advertising are still prohibited. While we do not think that these rules are having much effect on competition for the business of major clients, we think that they have adverse effects in the case of small businesses and individuals. *Restrictions on receiving a payment for referring clients to a particular professional or firm*

We believe that these rules are inhibiting the development of on-line market-places for legal services.

(ii) *Fee guidance*

We believe that this restricts price competition in certain services, notably probate.

**Law: barristers**

443. We see two demarcation issues as having an adverse effect on competition.

(i) *Right to conduct litigation*

The Access to Justice Act extended to the Bar Council authorisation to grant rights to its members to conduct litigation, but the Bar Council has chosen not to do so. In our view, this limits the number of competing lawyers with the right to conduct litigation (although other restrictions, such as those on direct access to clients (see paragraph 445 below) may also impede the ability of barristers to compete in the provision of these services).

(ii) *The QC system*

Although no area of work is formally reserved to QCs, in practice major litigation almost always requires the use of a QC. This is partly because of a perception that judges are more likely to take notice of a QC and partly because, if one side hires a QC, the other feels at a disadvantage if it does not do the same.

Given this, we think that the system as currently operated restricts competition because:

- There is anecdotal evidence of a quota on the number of new appointments, and the numerical evidence is consistent with the anecdotal;

- Selection is done by government, rather than by any market-based process; and,
- There is dissatisfaction among solicitors and some barristers about the fairness and accuracy of the selection process.

We do not think that a mark of quality or experience is necessarily anti-competitive, so long as award is governed by transparent and objective criteria, and restriction is done on a qualitative, rather than quantitative, basis. On the evidence available to us, however, the current system does not pass these tests.

444. We have found one constraint on structure to have an adverse effect on competition.

*Prohibitions on partnerships between barristers, MDPs and incorporated practices*

We believe that these restrictions may be economically inefficient, in that they prevent barristers from adopting other forms of business structure (e.g. sharing risk with other barristers or non-barristers through a partnership). They may have the further effect of deterring entry (e.g. from those who are risk-averse).

445. We believe that two conduct restrictions have an adverse effect.

(i) *Restrictions on barristers having direct access to clients*

We believe that this restricts the ability of barristers to market their services in competition with each other and with solicitors.

(ii) *Advertising restrictions*

Comparative fee advertising is still prohibited. While we do not think that this restriction is having much effect on competition for the business of major clients, we think that it may have adverse effects in the case of small businesses and individuals – the prohibition would become more significant if action were taken on the restrictions on direct access to clients and the right to conduct litigation (see paragraph 443 above).

446. We do not believe that the distinction between barristers and solicitors is a matter for concern, so long as action is taken on the demarcation issues listed above.

**Accountancy**

447. There is one significant indirect entry restriction in terms of permitted business structures.

*The ‘50% rule’*

The rule that, to carry out audits, 50% of a firm’s partners (or directors) must be audit-qualified is a significant restriction of competition. This rule may inhibit, for example, large non-accountancy firms from entering the market through the acquisition of small high street firms. Moreover, the 50% rule will inhibit the

development of MDPs. Because it implements a requirement of the 8<sup>th</sup> Directive on company law, its reform would have to be implemented at European level.

448. We have found two conduct restrictions which have an adverse effect on competition.

(i) *Advertising restrictions*

Cold-calling and comparative fee advertising are prohibited. While we do not think that these rules are having much effect on competition for the business of major clients, we think that they have adverse effects in the case of small businesses and individuals.

(ii) *Restrictions on receiving a payment for referring clients to a particular professional or firm*

We believe that restrictions on the referral of business is inhibiting the development of on-line accountancy marketplaces (a potential new spur to competition).

**Architecture**

449. We have discovered only one restriction which has an adverse effect on competition, a conduct rule.

*Fee guidance*

Our evidence suggests that RIBA's current fee scales are not related to market forces, and thus may be inhibiting price competition to some degree.

450. Much progress has already been made in reducing the adverse effect on competition of restrictions in the professions in this country. The above conclusions suggest that some adverse effects still remain.

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## **Annex A List of Interviewees**

1. Andrew Dismore MP
2. Architects Registration Board
3. Arthur Andersen
4. Bar Council
5. British Institute of Architectural Technologists
6. Chartered Institute of Public Finance Accountants
7. CMS Cameron Mckenna
8. Confederation of British Industry
9. Consumers Association
10. Department of the Environment, Transport and the Regions
11. Department of Trade and Industry
12. HM Treasury
13. Insolvency Service
14. Institute of Chartered Accountant in England and Wales
15. Law Society
16. Leigh Day & Co
17. Lord Chancellor's Department
18. Morgan, Lewis Bockius
19. R. Pau & Co.
20. Royal Institute of British Architects
21. The 100 Group
22. University of Essex - Professor Prem Sikka
23. University of Portsmouth - Stella Fearnley and Richard Brandt

Many interviewees made it clear that they were speaking in a personal capacity rather than on behalf of their organisations.

## **Annex B Summary of MMC reports into professional restrictions**

- 1) Advertising restrictions on advocates (Scotland).
- 2) Advocates: Senior Counsel and Juniors (Scotland).
- 3) Advertising restrictions on solicitors (Scotland).
- 4) Advertising restrictions on solicitors (England and Wales).
- 5) Advertising restrictions on barristers (England and Wales).
- 6) Barristers: Queen's Counsel and Juniors (England and Wales).
- 7) Advertising restrictions on accountants (England and Wales).
- 8) Restrictions on fees charged by architects.

### **(1) MMC Report into advertising restrictions on Scottish advocates, 1976<sup>105</sup>**

1. This Report concerns advocates operating in Scotland and in particular their restrictions on advertising services. The MMC concluded that a monopoly situation existed in favour of advocates in Scotland, but did not operate against the public interest.
2. The principal arguments brought forward against the restrictions were: (a) they deprive users of helpful information, (b) they act as a barrier to potential entrants in the profession, (c) they reduce the stimulus for competition, and thus efficiency, cost saving, innovation and the setting up of new practices, and, (d) they may enhance covert means of attracting business.
3. As far as the first argument was concerned, the MMC deemed that there was no issue. Clients use particular advocates at the suggestion of their well-informed solicitors. As the number of available advocates is small and concentrated in Edinburgh, experienced solicitors do not seem to have a problem obtaining the necessary information on advocates.
4. On the second argument, the MMC deemed that newly admitted advocates would not expect to gain any significant advantage by advertising. The reason is that new advocates are already known to solicitors as a result of their period of work at a solicitor's office before they became advocates.
5. The third argument, concerning efficiency, is turned down by virtue of the nature of an advocate's profession. An advocate's efficiency is largely his personal ability. Efficiency gains are very limited in issues of work organisation, machinery, etc. Also the argument that restrictions make it more difficult to set up new practices is scarcely relevant to advocates. All advocates must work as individuals and establish their own

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<sup>105</sup> Advocates' Services: A Report on the Supply of Advocates' Services in Relations to Restrictions on Advertising (1976)

separate practices (as a result of other restrictions). Additionally, while it is likely that advertising restrictions may encourage indirect (and at times questionable) ways of attracting business, there was no evidence of this happening so far.

**(2) MMC report into the advocates' profession in Scotland, 1976<sup>106</sup>**

6. The MMC found that all advocates in Scotland (Seniors and Juniors together, as a Junior must always be employed together with a Senior) face restricted competition as a result of the two-tier system. It decided that a monopoly situation existed in favour of the advocates that operated against the interest of the public. In conclusion, the MMC considered that the ultimate decision to hire a Senior and a Junior, or a Senior alone, should lie with the client. However, the MMC recognised that it is important for Senior Counsel to be able to devote time to more difficult cases, and therefore have the right to request the assistance of a Junior at a later stage in a case.
7. The essential issue discussed is whether there should be mandatory restrictions determining the circumstances in which a Senior Counsel should have the assistance of a Junior. These restrictions are considered: (a) in relation to court appearances, (b) in relation to written work connected with court proceedings and, (c) in relation to tribunals.
8. In (a), the MMC's view is that there are cases where the restriction requires the employment of a Junior where such employment is not necessary. This involves unnecessary expense to the litigant, waste of the Junior's time and possible delays in finding times for court appearances that fit in with engagements of those concerned in the case. It also involves a restriction of choice for the client.
9. In (b), the argument is raised that in the absence of supply restrictions, an unassisted Senior Counsel may have to devote time in routine legal writing to the detriment of his true function. The MMC considered this fear exaggerated, but it accepted that Juniors should do the great bulk of writing. In (c), the MMC deemed that for the same reasons as in (a) it should not be necessary for a Senior to be accompanied by a Junior.
10. The rigidity of the Scottish rule for these situations is discussed in comparison with the English equivalent. The main argument against the abolition of the restrictions is that it will destroy the two tier system and solicitors would press the Senior Counsel, particularly those recently appointed, to take cases on their own and do the necessary writing. According to the MMC, the fact that there are undoubted advantages in having a Junior to assist a Senior provides substantial proof that the two-tier system would flourish without the restrictions.
11. In defence of the restrictions, the argument is raised that the abolition of restrictions could force Seniors to act in cases more appropriate to their Juniors. The MMC finds

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<sup>106</sup> Advocates' Services: A report on the supply by Senior Counsel alone of their services (1976).

this implausible, and claims that before the 1907 restrictions were established there was no evidence of difficulties on that score. The point is also raised that if Senior Counsel were employed in the role of a Junior, then clients would pay more, and Juniors might be forced to raise fees in their preparatory work to offset their loss of income from their reduced hiring. The MMC thinks that both issues are exaggerated and are unlikely to be important.

**(3) MMC report into advertising restrictions imposed on solicitors in Scotland, 1976<sup>107</sup>**

12. The MMC concluded that a monopoly situation existed in favour of the solicitors in practices relating to advertising and operated to the disadvantage of the public interest. The MMC, however, acknowledged that there was a case for a degree of restriction on advertising services. The MMC recommended that solicitors should use methods of publicity whenever they think fit, given that they do not claim superiority, contain inaccuracies, and are not of disreputable character. The Professional Practice Committee and the Solicitors Disciplinary Committee should judge violations of these guidelines.
13. In defence of the restrictions, it is asserted that behaviour of a commercial nature, and in particular advertising, leads to mistrust because of the conflict between the client's 'real' interest and what the client wants to hear. The MMC rejected that claim on the basis that the tradition and sense of responsibility of solicitors is too strong to allow this to happen.
14. There were three principal objections to the restrictions on advertising imposed on solicitors. First, they deprive users and potential users from services, and potential entrants from offering those services. Second, they reduce the stimulus to efficiency. Third, restrictions may enhance covert ways of attracting business.
15. As far as the first point is concerned, the MMC recognised that solicitors have made significant investments in terms of collective advertising in directories, guides, etc. However, it deemed that individual advertising would yield additional information or spread information more effectively. With regard to the efficiency argument, the MMC considered that a limited number of firms might wish to advertise heavily in order to expand their business significantly and achieve larger scale economies through significant investment in their staff (i.e. hiring specialised solicitors). The inability to increase their business via advertising may deter some of the most enterprising solicitors from innovating. The MMC also claimed that restrictions on advertising would prevent the setting up of new practices, and thus decrease competition. Additionally, in areas where solicitors compete with unrestricted professions, solicitors should be allowed to advertise as well, for the benefit of the public interest.

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<sup>107</sup> Services of Solicitors in Scotland: A Report on the Supply of Services of Solicitors in Scotland in Relation to Restrictions on Advertising (1976).



**(4) MMC report into advertising restrictions imposed on solicitors, 1976<sup>108</sup>**

16. The MMC concluded that a monopoly situation existed in favour of solicitors (in England and Wales) in relation to advertising restrictions and that it operated against the public interest. This report is identical to (3) above, with the addition of an extra comment on law centres. The MMC states that the operation of law centres has been impeded by restrictions on advertising, as solicitors who work in Law Centres are not allowed to tout their work.

**(5) MMC report into advertising restrictions imposed on barristers, 1976<sup>109</sup>**

17. This report focused on barristers in England and Wales. The MMC concluded that a monopoly situation existed in favour of barristers in relation to advertising restrictions. The monopoly situation, however, did not operate to the disadvantage of the public interest.

18. There were three principal objections to the restrictions on advertising imposed on barristers (the same three that were raised for solicitors in (1), (3) and (4)). First, they deprive users and potential users from services, and potential entrants from offering those services. Second, they reduce the stimulus to efficiency. Third, there is the case that restrictions may enhance covert ways of attracting business.

19. In the MMC's view, the first objection was not an issue as clients use barristers at the suggestion of their well-informed solicitors. Solicitors are experienced and do not seem to have problem obtaining the necessary information on barristers. With regard to potential new entry, the MMC believed that it was through the membership of chambers that a barrister became known. A successful performance in chambers guarantees establishment, more than any form of self-promotion.

20. As far as the efficiency argument is concerned, the MMC considered a barrister's efficiency to be largely down to personal ability. Efficiency gains would be very limited in issues of work organisation and so on. Also, the argument that restrictions make it more difficult to set up new practices is dismissed on the basis that all barristers must work on their own and establish their own separate practices. New chambers are set up by experienced and already well reputed barristers. Finally, while there is a possibility that advertising restrictions may encourage indirect (and at time questionable) ways of attracting business, the MMC found no evidence to support this.

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<sup>108</sup> Services of Solicitors in England and Wales: A Report on the Supply of Services of Solicitors in England and Wales in Relation to Restrictions on Advertising (1976).

<sup>109</sup> Barristers' Services: A Report on the Supply of Barristers' Services in Relation to Restrictions on Advertising (1976).

**(6) MMC report into Barrister’s services, 1976<sup>110</sup>**

21. This report concerned barristers in England and Wales. The MMC concluded that a monopoly situation existed in the practice of the two-counsel system and operated to the disadvantage of the public interest. The MMC recommended that the two counsel rule should be abolished.
22. The essential issue was whether there should be mandatory restrictions determining the circumstances in which a Senior Counsel (Queen’s Counsel or QC) should have the assistance of a Junior (‘double manning’). The restrictions are considered: (a) in relation to court appearances (b) in relation to written work and (c) in relation to consultation.
23. In (a), the MMC discussed situations where the current rules were restrictive. For example, a mandatory rule does not allow for cases where a QC can conduct a case efficiently alone (or perhaps with the assistance of a case solicitor rather than a Junior). As a result, this restriction involves cost to the litigant, waste of the Junior’s time and possible delays in finding times for court appearances.
24. With regard to (b), two types of written work were considered. The first was written work connected with court proceedings. There was general agreement that interlocutory work should be done by the junior. While the MMC considered that there were disadvantages in providing for this by means of a rule, they did not wish to see a substantial change in the present practice. The second type of written work considered was documents not required in litigation. The MMC’s view was that a QC should be entitled to draft any documents on his own. In relation to (c), the MMC thought that it was better not to have any rule rather than have one that gives rise to misunderstandings.
25. As with the report on advocates (see (2) above), the MMC dismissed the argument that abolition of the restrictions would destroy the two tier system. In its view the advantages in having a Junior to assist a Senior would in itself ensure that the two tier system remained in place without the support of restrictions. The argument was also advanced that the two counsel rule was necessary to counteract the cab-rank rule (no lawyer shall refuse to render services) and ensure that QCs were not forced to take on cases more appropriate to their Juniors. Consistent with the view taken on advocates (see (2)), the MMC found this argument implausible.

**(7) MMC report into advertising restrictions imposed on accountants, 1976<sup>111</sup>**

26. The MMC concluded that advertising restrictions harm competition in the market for accountancy services in Great Britain (the report embraced four professional bodies -

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<sup>110</sup> Barrister’s Services: A report on the supply by Her Majesty’s Counsel alone of their services (1976).

<sup>111</sup> Accountancy Services: A Report on the Supply of Accountancy Services in Relation to Restrictions on Advertising (1976).

the three Institutes of Chartered Accountants, and the Association of Chartered Accountants) and operated to the disadvantage of the public interest. Consistent with their conclusion in (3) above, the MMC recommended that accountants should use methods of publicity whenever they think fit, given that their claims do not claim superiority, contain inaccuracies, and are not of a disreputable character. The four professional bodies should judge violations of these guidelines.

27. The key argument brought forward in defence of the restrictions was that accountants regard themselves in a position of trust with regard to both their clients and also with the public. The MMC, however, could not see why advertising should effect accountants' impartiality or their clients' perception of it (although it acknowledged that there was a certain kind of advertising that could have this effect). Therefore, the MMC considered there to be a case for the continuation of a certain degree of restrictions on the advertising of accountancy services.
28. The MMC listed three principal objections to restrictions on advertising (the same objections raised in (1), (3), (4) and (5)). First, they deprive users and potential users from services, and potential entrants from offering services. Second, they reduce the stimulus to efficiency. Third, they may enhance covert ways of attracting business. A fourth argument put forward by the accountancy professional bodies was that similar restrictions existed abroad, and a unilateral liberalisation in the UK may have a disadvantageous effect on UK companies.
29. As far as the first argument is concerned, the MMC's assessment was that while customers claimed to be content with the amount of information available to them, they might nevertheless be unaware of alternatives. The MMC saw no reason why accountants should be barred from stating publicly their profession, specific qualifications, their interests in particular classes of clients, and aspects of service.
30. As far as the second point was concerned, the MMC deemed that a limited number of firms might wish to advertise heavily in order to expand their business and achieve economies of scale or introduce innovative new services. The MMC also claimed that restrictions on advertising were preventing new entry, and thus inhibiting competition. Third, the MMC believed that restrictions on advertising could enhance less desirable ways of attracting custom, and tend to create a false image about the profession. Finally, the MMC dismissed the fourth argument on the grounds that the UK can lead the way in the reform of advertising restrictions.

#### **(8) MMC report into restrictions on fees charged by architects, 1977<sup>112</sup>**

31. The ARCUK (now the ARB) Code of Professional Conduct required that an architect should be remunerated for his professional services solely by fees payable by his client on a scale published by one or other of its constituent professional associations. The MMC concluded that through this mechanism the architects conducted their

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<sup>112</sup> Architects' Services: A Report on the Supply of Architects' Services with Reference to Scale Fees (1977).

affairs so as to restrict competition and that this operated against the public interest. The MMC called for the abolition of mandatory scales but decided that scales offered on a recommended basis would not operate against the public interest, provided that they were determined by an independent, government-appointed committee.

32. The Royal Institute of British Architects (RIBA) stated that the profession of architecture was more exposed than other professions to fee cutting, because of the fluctuations in demand for its services. The MMC, however, considered that lower fees during a recession could be counterbalanced by higher fees during periods of peak demand.
33. RIBA argued that because of the disparity in size between architect and client, the abolition of fee scales would leave architects in a weak bargaining position. The MMC disputed this, and claimed that their bargaining position was determined by reputation and the option to do alternative work, rather than size.
34. RIBA claimed that if fees fell, architects would perform their work less conscientiously. The MMC, however, believed that competition for quality services would remain, as most clients would be able to recognise the technical shortcomings of architects.
35. RIBA asserted that, in the absence of bargaining strength, an architect would have to neglect his broader responsibility towards the community and the potential users of the building in order to be able to strike a commercial agreement with the client. The MMC did not think this would be any more of a problem than in the presence of mandatory fee scales.
36. Due to the long and unpredictable duration of an architect's engagement, RIBA argued that fee scales satisfy a demand for certainty from clients. This saves both sides from lengthy negotiations that could breach the special relationship between architect and client. The MMC's view is that this argument was exaggerated and that in any case the relationship between architect and client is fundamentally of commercial character and would therefore benefit if both sides were free to negotiate.
37. RIBA also claims that under the fee scale system architects' earnings are not abnormally high compared to other professions. The MMC rejected that comparison and stated that the competitive restraints on private architects' fees arising from in-house architects and unqualified service providers were limited as they essentially served different markets.
38. Finally, it is contended that fee scales would be cut in practice if they were considered to be high - but their persistence was proof that they are not unreasonable. The MMC rejected this claim and also criticised the fee scale system for not adequately differentiating between different types and sizes of projects.

## Annex C The ‘truncated rule of reason’

1. In the USA the competition authorities are pioneering an analytical approach that puts less emphasis on market definition and market power (or appreciable effect) and more emphasis on justifications for restrictions, their impacts on competition and alternative means of addressing market failure. In other words, the focus is on the framework we set out in Chapter III. The so-called “truncated rule of reason” approach represents an attempt by the US competition authorities to “streamline” their caseload. They are striving for an approach to tackle “non-price” horizontal agreements with possible efficiency justifications - that cannot be dismissed as *per se* violations - but which in a way which avoids use of the *full rule of reason* (with its attendant requirement formally to establish market definition and market power). So, whilst mandatory fee scales might be classed as *per se* violations, restrictions on advertising could be found to be anti-competitive on the basis of absence of efficiency justification and an impact on competition (or on the basis that there exists an alternative, less competitively damaging restriction with an efficiency justification).
2. A full analysis of market definition and market power is avoided on the grounds that the latter is difficult to assess in the case of professional restrictions. Protagonists of the “truncated rule of reason” argue that professional bodies with market power may generate anti-competitive effects even with relatively low market shares because of the impact of third party perceptions; they also argue that fees may already be at such a level as to fall foul of the famous *cellophane fallacy*<sup>113</sup> and lead to an excessively wide market definition. Interested readers should refer to *Langenfeld, Silvia and Winslow*<sup>114</sup> for a full discussion.
3. Although this approach has been applied successfully to professional restrictions in three Supreme Court cases, namely *National Society of Professional Engineers v US*, *NCAA v Board of Regents* and *FTC v Indiana Federation of Dentists*, it remains a matter of considerable controversy. After reviewing these three precedents, the Supreme Court (in *California Dental Association v FTC*, 1999, where the FTC used the truncated rule of reason approach) stated that: “*quick-look analysis carries the day when the great likelihood of anti-competitive effects can easily be ascertained*” but found in the CDA case that the FTC had failed “*to present a situation in which the likelihood of anti-competitive effects is [comparably] obvious*”<sup>115</sup>.

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<sup>113</sup> *US v El du Pont de Nemours & Co* (1956). If prices *already* exceed the competitive level, inclusion in the relevant market of products that would form substitutes if the price was increased yet further could lead to the erroneous conclusion that those products prevented the exercise of market power and that the market was competitive.

<sup>114</sup> Langenfeld, Silvia and Winslow: *Analysis of non-price horizontal restraints*, 1992

<sup>115</sup> 119 S.Ct. at 1613 cited in Calkins: *California Dental Association: not a quick look but not the full monty*”, *Antitrust Law Journal*, 2000. The key concern was advertising restrictions imposed by CDA.

## Annex D Table of restrictions assessed

### Law

<b>Restriction</b>	<b>Origin</b>
<b>1. Division between solicitors and barristers</b>	Separate historical development of each professional body
<b>2. Direct access to clients by solicitors but not barristers</b>	Bar Council Code of Conduct
<b>3. Sole practice distinguishing feature of Bar</b>	Bar Council Code of Conduct
<b>4. Right to conduct litigation (formerly solicitors only. Now extended to Bar and legal execs, but Bar choosing to allow only employed barristers to take up right).</b>	Solicitors' Act, Access to Justice Act 1999 (AJA), Bar Council Code of Conduct
<b>5. Advocacy rights (restrictions now in theory removed)</b>	AJA 1999. See proposed new regulations in Higher Courts Qualification Regulations 1998 and 2000.
<b>6. Phase out term "Non-practising" barristers - all barristers must have undertaken pupillage</b>	Bar Council Code of Conduct
<b>7. Distinction between QCs and junior barristers</b>	Custom & practice reinforced by client perception. LCD eligibility criteria. Bar Council Code of Conduct
<b>8. Advertising restrictions in addition to general restrictions protecting taste, decency, truthfulness etc. - e.g. cold-calling.</b>	Bar Council Code of Conduct (barristers), Solicitors Publicity Code (solicitors)
<b>9. Restrictions on individuals and organisations from referring clients to particular legal and accountancy service providers who would be able to meet clients particular transactional needs</b>	Solicitors Practice Rule 3
<b>10. Restrictions on permitted business structures e.g. MDPs</b>	Bar Council Code of Conduct paragraph 205 (Barristers) Solicitors Practice Rule 7(Solicitors)

<b>Restriction</b>	<b>Origin</b>
<b>11. Employed solicitors cannot act for third parties and have restricted rights of audience in higher courts. E.g. restricts solicitors employed by legal expenses insurers from handling a claim above the "no costs" claims limit (currently £5000).</b>	Employed Solicitors' Code 1990; Solicitors' Practice Rule 4
<b>12. Legal professional privilege gives lawyers an unfair advantage over other providers of tax advice</b>	Solicitors Guide to Professional Conduct.
<b>13. Fee guidance - Solicitors</b>	Solicitors' (Non-Contentious Business) Remuneration Order 1994.
<b>14. Taxing mechanisms/fee reviews</b>	Solicitors' (Non-Contentious Business) Remuneration Order 1994 and The Solicitors Act 1974.
<b>15. Restricted ways of billing clients</b>	
<b>16. Reservation of particular types of work to lawyers (Solicitors or Barristers).</b>	The Solicitors Act 1974; CLSA 1990
<b>17. Cost and time required of training course (BVC) and availability of pupillage places, Barristers.</b>	Bar Council Code of Conduct, Consolidated Regulations.
<b>18. Cost and time required of training course (LPC) and availability of training contracts, Solicitors.</b>	Solicitors' Act 1974
<b>19. Continuous Professional Development requirements, Solicitors and Barristers</b>	Bar Council Code of Conduct and Law Society Training Regulations 1990 (amended) and Guidance
<b>20. Restrictions on referrals, individuals and organisations from referring clients to particular legal and accountancy service providers.</b>	Solicitors Practice Rule 3

## Accountancy

<b>Restriction</b>	<b>Origin</b>
<b>1. Restrictions on who can carry out a company audit.</b>	Companies Act 1989, EC Directives

<b>Restriction</b>	<b>Origin</b>
<b>2. Application of company audit rule to other accountancy work.</b>	Custom / 3 <sup>rd</sup> party perceptions; CIPFA members prevented from auditing charities and registered social landlords under Charities Act 1993 and Housing Act 1996 respectively.
<b>3. Exclusion of other non RPB accountancy bodies from proposed new regulatory framework for accountants</b>	CCAB Memorandum of Articles of Association.
<b>4. Government proposals to reduce statutory audit requirements for smaller firms</b>	Government consultation paper, October 1999
<b>5. Restrictions on permitted business structures, including the formation of MDPs</b>	Prohibition in Solicitors Practice Rule 7 on fee sharing and the ability to enter into partnership with persons other than solicitors (see also Solicitors Practice Rules 4 and 11). (P) See Reg. 4a and 4b, Reg. 7 , Reg. 16 (ii) and 16 (iv) of Regulations relating to the Use of the Description "Chartered Accountants" - applicable from 1.5.00. (supersedes p171 Members Handbook). Companies Act 1989, ICA Audit Regulations and Guidance.
<b>6. 50% of an audit firm must be qualified auditors</b>	See Reg. 4a and 4b, Reg. 7 , Reg. 16 (ii) and 16 (iv) of Regulations relating to the Use of the Description "Chartered Accountants" - applicable from 1.5.00. (supersedes p171 Members Handbook). s25 Companies Act 1989 restricts eligibility of auditors to members of RSBs (ICAEW, ICAI, ICAS, ACCA). Sch. 11, Part II S4(1)(b) states firm to be controlled by qualified persons. See ICA Audit Regulations and Guidance, Reg. 2.01 and 2.02 (as amended by errata and amendment insert). See also Regs 4.01 - 4.04. Rules for corporate practices are in Regs. 6.01 - 6.03)
<b>7. Entrance requirements: degree-level requirements for CCAB examinations, cost and availability of accountancy courses and training contracts.</b>	Chartered bodies have their own professional rules setting out requirements for entry and practice. See ICAEW and ACCA Handbooks. Some of these need to comply with statutory requirements (e.g. audits under Companies Act 1989.
<b>8 Prohibition of fee advertising &amp; "cold-calling"</b>	Under ICAEW Guidelines these practices are prohibited. See ACCA Rulebook 2000 . AAT Guidelines.
<b>9. Restrictions on individuals and organisations from referring clients to particular legal and accountancy service providers who would be able to meet clients particular transactional needs.</b>	See ICAEW HB p276 paragraph 5.0
<b>10. Fee-fixing / fee sharing amongst the larger accountancy firms</b>	Conduct/general business practice



<b>Restriction</b>	<b>Origin</b>
<b>11. Cross-subsidy between service types</b>	Fees are not regulated by professional bodies but fees charged to audit accounts must be disclosed in the accounts. See Companies Act 1985 s390A(3). See also Auditing Practices Board Statement of Auditing Standards.

## Architecture

<b>Restriction</b>	<b>Origin</b>
<b>1. Functional division between so called 'architects' and those qualified in architecture but not registered. You may only be called an 'architect' if you are registered with the ARB. Reinforced by third party perceptions.</b>	The Architects Act 1997, s4 (provisions relating to registration) and Part IV, s20 - use of the title 'architect'. Third Party perceptions.
<b>2. Entrance requirements: minimum seven years training</b>	Route for qualification set out by RIBA.
<b>3. Recommended fee scales</b>	RIBA - Guidance for Clients on Fees, RIBA Code of Conduct and 'A Clients guide for engaging an Architect', ARB Standard 11 - Architects Code: Standards of Conduct and Practice.
<b>4. Restrictions in accordance with general advertising codes, and the specification not to accept inducements or allow name to be used in advertising any service or product associated with the construction industry.</b>	Advertising Codes plus RIBA/ARB codes.
<b>5. Restrictions on the creation of MDP's. To gain entry into the RIBA directory, 80% of the practice must be architects.</b>	RIBA Charter and Byelaws; RIBA Directory.

**Annex E Excerpt of Kalisher report**





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*Dear Michael,*

When we met in December, I promised to let you have mock-ups of the briefing material provided to the Lord Chancellor on candidates for Silk.

With the Lord Chancellor's approval, I now enclose sample briefing sheets and comments on three fictitious candidates for Silk 1997 from three different areas of practice. They are intended to represent an unpromising candidate (Midgely), a strong candidate (Miss Askey) and a borderline candidate (Vellacott). These have been constructed from comments made in recent years. As you know, as part of the consultations for Silk 1994, consultees have been asked, if possible, in addition to their more general comments to assign candidates to one of five lettered classifications. I enclose a note of the definitions of the classifications used. I also enclose a sample of the advice about numbers and the apparent leading contenders which is provided to the Lord Chancellor in relation to each category. You will see that, in addition to more general briefing, we have prepared a sample relating to one of the categories, the fictitious 'East Midlands Circuit'. This section is designed to match the sample comments on Vellacott, the borderline candidate.

## SPECIMEN INFORMATION ON SILK CANDIDATES

Sample extract of material provided to the Lord Chancellor

### APPOINTMENTS - IN CONFIDENCE

#### SILK 1997

##### General

1. The background to this year's Silk round is that on 1 October 1996, just after the lists opened for applications, there were 8,807 barristers in practice at the English Bar. Of these 891 were Silks, 10.1% of the total Bar, in comparison with 10.3% which was the corresponding figure on 1 October 1995.
2. This year there has again been a record number of applications: 621 applications compared with 605 last time, and 592 in 1995.
3. Last year 76 new Silks were appointed on application (ie. excluding the four Honorary Silks also awarded). The total of 76 compared with 82 in 1995.
4. The field of candidates this year is mixed with outstanding candidates in some areas but rather disappointing fields for appointment in other categories. In some areas, there are doubts about how much work there would be for new Silks but in other areas a demand for Silks is evident. Overall, the quality of applicants and the tenor of the advice received seems to point towards slightly fewer appointments than the 76 made last year.

##### Consultations

5. Consultations about this year's applications included:

- a. The Bar. We have had meetings with the Law Officers, the Chairman of the Bar, the Leaders of the six Circuits, the Chairmen of the Criminal Bar Association, the London Common Law and Commercial Bar Association, the Commercial Bar Association, the Family Law Bar Association, the Chancery Bar Association, the Official Referees' Bar Association, the Revenue Bar Association, the Local Government and Planning and Environmental Bar Association, and the Administrative Law Bar Association, and the Leader of the Parliamentary Bar and the Leader of the Patent Bar and a leading landlord and tenant Silk. Comments have also been sought from a number of other Silks.
- b. The Judiciary. We have had meetings with the Master of the Rolls, President of the Family Division, the Vice-Chancellor, the Presiding Judges of the six Circuits, the senior Commercial Judge, the senior Official Referee and the Recorder of London, as well

as judges with experience of planning law, administrative law and landlord and tenant law, and the President of the combined Tax Tribunals. In addition copies of the full lists were sent to, and many comments have been received from, the Law Lords, all Lords Justices, all High Court Judges, Circuit Judges authorised to sit in the Chancery Division or on Mercantile Lists and all senior Circuit Judges in charge of major court centres. Comments were also sought from the British Judge and Advocate General at the European Court of Justice and the British Judge at the Court of First Instance, the British Judge at the International Court of Justice, as well as the Heads of Tribunals dealing with employment, social security and immigration matters.

The invaluable help of all these consultees is gratefully acknowledged.

#### Categories and Arrangement

6. The categories follow the same broad pattern in the past. A full list of the categories discussed below is as follows:

#### PROVINCIAL CIRCUITS

Midland and Oxford Circuit  
Northern Circuit  
North Eastern Circuit  
Western Circuit  
Wales and Chester Circuit

#### LONDON AND SOUTH EASTERN CIRCUIT - GENERAL

Criminal  
Common Law  
Commercial and Admiralty

#### FAMILY

Family

#### CHANCERY ETC.

Chancery  
Landlord and Tenant  
Intellectual Property  
Revenue

#### OTHER

Building and Construction  
Parliamentary, Planning and Local Government  
Administrative and Public Law  
European Community and International  
Other

7. The briefing on the applicants is divided into groups within each category. Those applicants who, on the strength of the backing they receive, deserve serious consideration for appointment this year (including all those who seem to be front runners) have been put into Part 1. This begins with the list of names, and then gives the usual briefing sheets on each individual, summarising particulars and then setting out the full

text of all comments received. These Part 1 applicants account for 138 of this year's total of 621. The remainder consist of those who receive rather less support either generally or for this year (ie. it includes some who may be regarded as promising for later years or who do not match the competition from stronger candidates in their field). The details of all these candidates are to be found in Part 2 of the material for each category. The Silk folders on all candidates, comprising the application form, the comments received and any other correspondence, are also of course available, should you need to consult them.

8. Once you have looked at the papers and and drawn up your provisional list, it will be circulated to the Heads of Divisions and the Law Officers as a basis for discussion. It will also be sent to the Chairman of the Bar for his comments. For your convenience, and that of the Heads of Divisions, the candidates in each category have been arranged with the apparent "probables" listed under A, very roughly in order of the weight of support they receive, and the apparent "possibles" under B.

### PROVINCIAL CIRCUITS

#### East Midlands Circuit

9. Last year there was three new Silks on this Circuit. This year the Leader and the Presiding Judges are agreed that there is room for three Silks, possibly four. As to candidates, the Presiding Judges and the Leader of the Circuit all agree that Toft and Sowerby are the clear front runners, but the Leader backs Keswick for the third place while Bunnett has the support of the Presiding Judges and most other commentators.

A

B S Toft (44)  
C T Sowerby (42)  
M V D Bunnett (47)

B

G G Keswick (45)  
O P Winston (41)  
E A Vellacott (48)

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## **Annex F List of restrictions not taken forward**

### **Law**

1. Introduction of restrictions on claims assessors conducting personal injury work.
2. Restricted admission to the Institute of Trade Mark Attorneys
3. QC commitment fees.
4. Accreditation of solicitors, CLS contracting to accredited specialists only.
5. Restrictions on solicitors providing advice at police stations.
6. Rules on conflict of interest.

### **Accountancy**

1. Continuous Professional Development requirements.
2. Cost and availability of accountancy courses and training contracts.
3. Quotas on the number of people permitted to pass entrance exams.
4. Unnecessary restrictions on accountants who qualify overseas.
5. Restrictions on appointments to the European Court of Auditors.
6. Restricted ways of billing clients.
7. Accountancy firms are prohibited (in line with SEC rules) from auditing firms in which their members have investments.
8. Accountancy firms should not be able to audit firms that account for a large proportion of their gross practice income.
9. Companies cannot appoint as independent financial advisors on the merger / take-over the corporate finance division of any company that also audits the company that is to be taken over / merged with.
10. Collusion between the "Big 5" with regard to the extent of the liability they will incur in business relationships.
11. Only a few accountants publish their accounts (e.g. Ernst & Young).
12. Alleged that ICAEW "over-represents" the interests of private practitioners as against those in industry.

### **Architecture**

1. Continuous Professional Development requirements.



## Annex G References

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