

Voorburg Group on Service Statistics

Legal Services within Producer Price Indexes

The New Zealand Experience

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Statistics New Zealand

Introduction

In recent years, a number of statistical offices have embarked on a process of including selected service activities within their PPI's. Due to the inherent difficulties in defining, quantifying and obtaining reliable pricing information for service activities, the most common approach has been taken has been to concentrate on a small range of discrete service activities. They spend considerable effort in investigating the issues surrounding the construction of price indexes for these activities before incorporating these areas within their respective PPI.

Statistics New Zealand (SNZ) has taken a somewhat different approach to services within the New Zealand PPI. Since the introduction of PPI indexes for the Insurance, Finance, Property and Business Services industries in November 1980, SNZ has produced Inputs and Outputs price indexes for all services industries across the range of market sectors of the New Zealand economy.

The inclusion of services industries within the PPI provides a valuable tool for deflation within the national accounts, and enables the production of industry Input indexes which reflect the price change in the totality of a firms factors of intermediate consumption, rather than simply that of goods and materials.

SNZ has taken a pragmatic approach to the construction of these indexes. New Zealand has a population of approximately 3.8 million people, and as such the resources available for the investigation and construction of service indexes within the PPI have been limited. The approach taken has been to start from the initial premise that the PPI is to be an economy-wide measure of the inflationary pressures faced by all market industries (including services industries). From there, price indexes have been developed using the best information possible, given existing budget constraints.

One of the major areas of difficulty in producing price indexes for service activities is that of collecting pricing information which is sufficiently quality-controlled for use within a price index. Where possible, SNZ uses a "model customer" approach to pricing services, in an attempt to provide this quality control. In many instances however, the development of such model prices has not been possible, and many service prices have in practice been represented by hourly charge-out rates that are collected from service providers.

There are a number of potential concerns arising from the use of charge-out rates as indicators of service prices. The major concerns include:

- The concern that labour productivity increases will result in the charge-out rates overstating the true price change for the service. This is of particular concern in the business service areas, where the adoption of computing and other technology has increased labour productivity.
- While labour costs will often account for the majority of the costs in the provision of many business services, there will often be other components (materials, disbursements, overhead charges etc.) which will contribute to the final cost of the service. The effect this will have on the appropriateness of charge-out rates as indicators of effective price movement is ambiguous.
- Charge-out rates can often remain constant for long periods of time, whereas the true price of the service may well be increasing. This can result from firms "padding" invoices with greater billed hours or higher overhead charges. This would lead to the charge-out rate understating the true inflationary pressures in the short term, and then recording periodic dramatic increases.

Given the above concerns in relation to the use of charge-out rates to represent the price of the services provided, an investigation has been undertaken in an effort to assess the appropriateness of using such charge-out rates. The investigation has looked at the pricing of legal services within the PPI, and has compared charge-out rates for barristers and solicitors with "model" prices that are collected within the PPI for a range of legal services.

Legal Services - Model Pricing

SNZ uses a "model pricing" approach to pricing legal services within the PPI. Specifications were developed (in consultation with legal professionals) for a range of legal services provided by the legal industry. Specifications (which are included in Appendix A) have been developed for the following legal services:

- Obtaining an injunction;
- Registration of a debenture;
- Estate administration;
- Incorporation of a company;
- Traffic offence.

These specifications are sent to respondents to the Commodity Price Survey each quarter for re-pricing. Twelve separate legal firms are contacted, selected purposively from a population stratified by turnover. The respondents selected account for approximately 60 percent of the gross output of the legal services industry in New Zealand.

In addition to the model prices, the respondents to the Commodity Price Survey are also requested to provide details of charge-out rates for practitioners with particular levels of experience. These charge-out rates are used to supplement the price indexes developed for the legal services industry.

From a practical perspective, one of the difficulties associated with the model pricing approach is the relative cost of pursuing this pricing mechanism. The specifications have to be developed in conjunction with professionals in the area, and require periodic maintenance as the business environment changes. The respondent in terms of reporting time also faces additional costs. This can be compared with the relatively cost-effective approach of collecting charge-out rates, which are typically readily available from the respondent, and do not require such intensive maintenance.

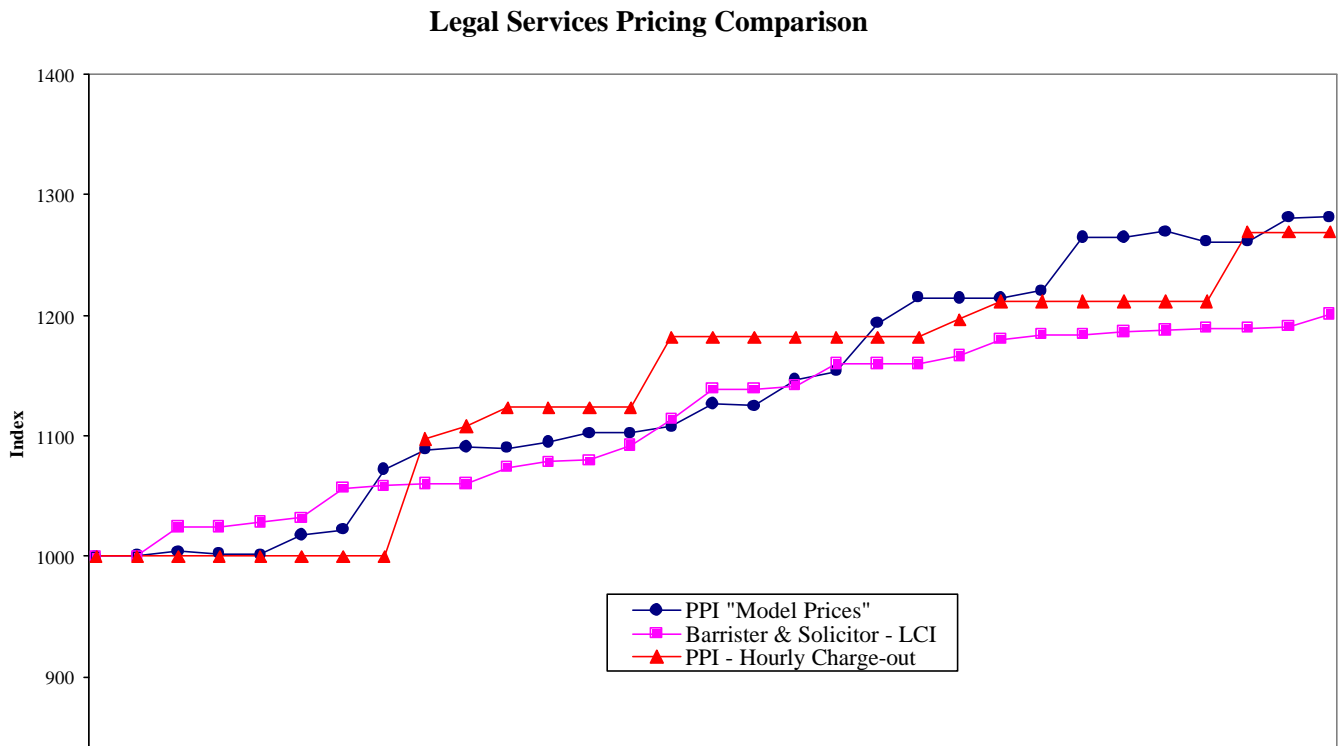
Comparison of Model Prices with Charge-out Rates

Unit-record pricing data (both model prices and charge-out rates) were extracted from the PPI items to price database, going back to December 1992. These individual prices were then aggregated to form two separate price indexes, one for the model prices and one for the charge-out rates. An additional series was also included, that being for ordinary salary and wage rates for barristers and solicitors from the Labour Cost Index (LCI).

The index numbers resulting from this comparison appear in Table 5 below.

Table 5: Legal Services Pricing Comparison						
Period	PPI		Barrister & Solicitor (LCI)		PPI - Hourly	
Dec-92		1000		1000		1000
Mar-93		1001		1000		1000
Jun-93		1004		1024		1000
Sep-93		1002		1024		1000
Dec-93		1001		1028		1000
Mar-94		1017		1032		1000
Jun-94		1022		1057		1000
Sep-94		1072		1058		1000
Dec-94		1088		1060		1097
Mar-95		1090		1060		1108
Jun-95		1090		1074		1123
Sep-95		1095		1078		1123
Dec-95		1102		1080		1123
Mar-96		1102		1092		1123
Jun-96		1107		1114		1182
Sep-96		1126		1139		1182
Dec-96		1125		1139		1182
Mar-97		1146		1141		1182
Jun-97		1153		1160		1182
Sep-97		1193		1160		1182
Dec-97		1215		1160		1182
Mar-98		1214		1167		1196
Jun-98		1214		1180		1211
Sep-98		1220		1184		1211
Dec-98		1265		1184		1211
Mar-99		1265		1186		1211
Jun-99		1269		1187		1211
Sep-99		1261		1189		1211
Dec-99		1261		1189		1269
Mar-00		1281		1191		1269
Jun-00		1281		1201		1269

The index numbers are presented in the following graph:



A number of interesting observations may be made from the resulting price series

- i) Of particular note is the observed tendency of the hourly charge-out rate to move in a "step-wise" manner. This is consistent with expectations regarding the movements of this indicator.
- ii) While there are a number of differences in the series examined in the short term, over longer time periods, it would appear that the series are relatively highly correlated.

The importance of the definition of the service

During the early 1990's, a number of new pieces of legislation were passed in New Zealand, which have resulted in additional complexities for legal professionals in their work. Examples of such legislation include:

- Companies Act
- Employment Contracts Act
- Resource Management Act

These (and other) pieces of legislation have significantly increased the complexity of many of the services performed by the legal profession. Given that the model pricing methodology approaches the definition of the service from an output perspective, they will capture price increases resulting from these additional complexities, while the charge-out rates will not. The question which must be asked, is this a result which we want to see come through in the price index series?

Answering this question goes right to the heart of the definition of the service being provided. One school of thought holds that when attempting to define a service category to be priced, we should attempt to define the service provided from the perspective of the service that is received by the end consumer. Where, therefore, a customer is seeking the incorporation of a company, what the customer is really "purchasing" is the registration of the company, rather than all of the steps involved in the process. If legislative and administrative changes now mean that this process takes the legal professional twice as long (and hence the price doubles) this would be viewed by the purchaser as a price increase. A qualification to this would be where the consumer demonstrably receives an additional benefit, the quality of the service will have increased, and the price should be adjusted accordingly. The "model pricing" approach is in effect capturing price change for the service defined in this "utilitarian" manner.

Another school of thought would argue that the service should be defined in terms of the individual tasks that constitute it. Any changes in the steps necessary to provide the service should be therefore viewed as quality changes, and the price adjusted accordingly. Where labour costs form a substantial proportion of the overall cost of the service being provided, the hourly charge-out rate would conceptually approximate the price of this service (taking into account labour productivity improvements). This would effectively involve "unbundling" the service and pricing its component parts.

Which of these two approaches is preferable is open to debate. It may well be that the answer lies in the purpose for which the index is to be used. If it to be used as an indicator of the price faced by firms consuming legal services (i.e. as part of their intermediate consumption), then the "utilitarian" approach should be adopted. If, however, it is to be used as an indicator of the output price, and is to be used to deflate current dollar sales to arrive at a constant price measure of the output of the legal services industry, then arguably the "unbundled" approach should be adopted.

Conclusion

The preceding investigation represents an initial investigation into the validity of using charge-out rates to represent services activities. It has focused on a specific category of business service, and as such comparisons with other services can not be readily made. There have been a number of developments (legislative changes etc.) that have impacted on the legal industry over the last decade that may not have impacted to the same extent on other service industries.

Notwithstanding the limited scope of the investigation, a number of interesting points can be made:

- The definition of the service being provided is of paramount importance in constructing price indexes for service activities. This definition may well depend upon the uses to which the price index will be put, and this will in turn impact upon the choice of an appropriate pricing methodology.
- While there are clearly some short-term differences in the index series derived from using model prices as opposed to charge-out rates for legal services, over the medium to long-term these differences are not necessarily as large as might have been expected.
- Where the additional costs involved in developing and maintaining a model pricing methodology for service activities are significant, it may be that the use of charge-out rates can provide an cost-effective substitute while still returning a meaningful time series.

APPENDIX A: LEGAL PRICE SPECIFICATIONS

STANDARD SPECIFICATION FOR OBTAINING AN INJUNCTION

1. You are contacted by the managing director of a client company. He advises that the company has been served with a Section 218 notice and requests an urgent appointment to see you.
2. Preliminary interview with managing director in which he:
 - a) Gives you a brief outline of the circumstances giving rise to the issue of the notice;
 - b) Hands you relevant documents; and
 - c) Inquires what steps should be taken.
3. You first check the section 218 notice to see when the time expires after which the creditor can issue a statement of claim.
4. Having ascertained what date, you then advise the managing director that, having regard to the short time available, you will study the documents and let him have your advice very shortly.
5. Over the ensuing 48 hours you spend time studying the documents and then write to the solicitors who issued the section 218 notice. The purpose of this letter is:
 - a) To point out that the debt is disputed and that therefore a section 218 notice is inappropriate;
 - b) To advise them that, in any event, your client has a claim which exceeds the amount of the disputed debt;
 - c) To ask them whether, in view of the above, they still intend proceeding; and
 - d) To advise them that unless you hear from them within seven days that they do not intend proceeding, you will apply to the Court for an injunction.
6. Within seven days a reply is received advising that they do not consider your client's position to be financially strong; that they do not consider that the debt is genuinely disputed and that they do intend proceeding if the money is not paid or security given.
7. Following this there is a lengthy consultation with the managing director for the purpose of preparing the documentation necessary to obtain an injunction. As it is necessary to persuade the Court that the dispute over the debt is a matter of substance and not simply a smoke-screen designed to put off the evil day; full details of the dispute must be given.
8. The following documents are then prepared for filing in the Court:
 - a) Statement of claim and notice to defendant asking for:
 - i) A declaration that the alleged debt is not owing;
 - ii) Damages for breach of contract; and
 - iii) Costs.
 - b) An ex parte application for injunction restraining the defendant company from issuing and/or advertising a winding up petition on the grounds that:
 - i) The debt is disputed;
 - ii) There is a claim which exceeds the amount of the disputed debt.
 - iii) The presentation and advertising of the petition will do irreparable harm to the plaintiff company.
 - c) An affidavit from the managing director of the plaintiff company setting out full details of the disputed debt and the background to it.
9. These documents are then filed in the Court. The motion is ex parte because of the urgency of the situation and the fact that when the proceedings are filed the time for the expiry of the notice has almost arrived. If there were ample time then the motion would inevitably have to be served on the other party.
10. In the first instance the papers are placed before the Judge and he makes an order after perusal of the papers. He does not call counsel to see him for further clarification of the issues.
11. You arrange to have the order sealed in the Court and served on the defendant company forthwith to prevent the statement of claim for winding up proceeding.

STANDARD SPECIFICATION FOR REGISTRATION OF DEBENTURE

Assume: Your client company is asked to give a debenture to its trading bank to see fluctuating overdraft and other banking accommodation up to \$25,000. The bank's debenture is to take priority over an existing debenture to a finance company securing \$10,000 fixed item of plant.

1. Receive letter of instruction from lending institution. Check:
 - (a) level of accommodation;
 - (b) interest and finance rate (servicing ability).
2. Search company including Memorandum and Articles. Check that company has power to give such a security. Obtain full details of prior charge.
3. Confirm lending institution's instructions and conditions with client.
4. Peruse trading bank's debenture (standard form).
5. Complete details in debenture.
6. Prepare Declaration of Due Execution and company resolutions including Disclosures of Interest. Ensure that the same conform with the company's Articles of Association.
7. Prepare Deed of Modification of Priority and obtain confirmation from on debenture holders to the terms thereof.
8. Attendances on execution of the following documents:
 - (a) Resolutions incorporating appropriate Disclosures of Interest;
 - (b) Debenture;
 - (c) Declaration of Due Execution;
 - (d) Deed of Modification of Priority.
9. Attendance's on Disclosure.
10. Arrange noting of appropriate insurance policy.
11. Forward priority document to other debenture holder for execution and return.
12. Register Companies Office copy of debenture.
13. Forward certificates to lending institutions to confirm compliance with requirement and request drawdown of funds.
14. Report to client.
15. Uplift funds and disburse.
16. Attend to stamping of Deed of Priority
17. Forward final solicitor's certificate to lending institutions together with debentures security documents including Section 105 certificate, Deed of Priority and insurance policy.
18. Final report to client.

STANDARD SPECIFICATION FOR ESTATE ADMINISTRATION

Work involved in approximate chronological order

1. Preliminary interview with executor, discussion of terms of the will, the nature and approximate length of time of the administration of the estate and likely cost.
2. Written report to executor, supplying copy of will and summary of administration.
3. Drafting Affidavit to Lead Grant of Probate, Affidavit of Death where necessary. Notice of Application to the Court for Grant of Probate. .
4. Attendance on executor and having Affidavits sworn.
5. Filing Application and Affidavit(s) at High Court Registry.
6. Preparing and sending letters to Postbank, Life Insurance Company and Trading Bank seeking particulars of derived and accrued interest for tax purposes and amount payable to estate.
7. Receiving responses from them.
8. Searching certificate of title to house property.
9. Obtaining death certificates (2) (and birth certificate if age not admitted by the insurance company).
10. Receiving minute of Court's Order on application for Probate, preparing formal Grant of Probate and Declaration in value of estate.
11. Sealing Grant of Probate and filing Declaration at High Court Register
12. Preparing Transmissions by Survivorship of jointly owned house property.
13. Preparing taxation returns to date of death.
14. Reporting to executor, supplying Schedule of Assets and Liabilities.
15. Attending on widow/er for execution of Transmission.
16. Advising rates authority, Valuation Department, insurance company, electrical supply authority and Telecom re telephone, of transfer of joint house property to widow/er.
17. Attending at Land Transfer Office with Transmission (death certificate annexed) and certificate of title for registration.
18. Receiving release of Probate from High Court.
19. Completing life insurance discharge, specimen signature and withdrawal forms for Postbank and trading back accounts.
20. Arranging execution of discharge and withdrawal forms by the executor.
21. Forwarding life insurance policy, death certificate (and birth certificate) discharge and probate to life insurance company requesting payment.
22. Receiving return of Probate from life insurance company together with cheque in settlement. Arranging for payment into trust account.
23. Forwarding specimen signature and withdrawal forms and Probate to trading bank and arranging for closing of account, final bank statements and payment.
24. Receiving return of probate from trading bank and cheque in settlement. Arranging for payment of cheque into trust account.
25. Forwarding specimen signature and withdrawal forms and Probate to Postbank and requesting payment to the estate.
26. Receiving return of Probate from Postbank together with cheque in settlement. Arranging for payment into trust account.
27. Payment of debts including funeral expenses.
28. Reporting to executor and beneficiary and arranging payment of interim distribution to beneficiary if required.
29. Receiving, checking and paying assessment from Inland Revenue Department in respect of taxation return to the date of death.
30. Preparing final estate accounts.
31. Preparing a trustee's tax returns from date of death to date of distribution.
32. Final report to executor and beneficiary supplying final statements.
33. Attendance on executor to discuss final accounts and make payment of the balance held in trust.
34. Sundry telephone attendances (say 5) during administration.

STANDARD SPECIFICATION FOR INCORPORATION

Assume: You are consulted by a husband and wife who have purchased a suburban bookstore. They wish to operate the business as a limited liability company with a nominal capital of \$10,000. The husband and wife wish to be the shareholders and directors and they wish their accountant to be the secretary.

1. Preliminary discussion canvassing:
 - 1.1 Reason for incorporation
 - 1.2. Concept of limited liability
 - 1.3. Level of paid up capital and reasons why.
 - 1.4. Selection of proposed name.
 - 1.5. Shareholders, Directors and Secretary
 - 1.6. Type of business.
 - 1.7. Registered office.
 - 1.8. Bankers.
2. Name approval. Forward application for name approval to Registrar of Companies, Wellington, including disbursement.
3. Receive name approval.
4. Draft company documents including:
 - 4.1 Articles of Association.
 - 4.2 Memorandum of Association.
 - 4.3 Notice of Situation of Registered office.
 - 4.4 Particulars of Directors and Secretary.
 - 4.5 Consent to Act as Director.
 - 4.6 Consents to Act as Secretary.
 - 4.7 Minutes of first meeting of Directors.
5. Order Common Seal.
6. Collect funds from clients to cover disbursements including approval fee, registration costs and Common Seal.
7. Attendances pertaining to explanation of Articles, Memorandum, powers and rights pursuant thereto, obligations of officers, accounting method, opening of banking accounts and payment of capital.
8. Attendances on execution of documents
9. Submit documents to Companies Office for registration.
10. Receive advice as to incorporation.
11. Report and account to clients and advise of incorporation, forward incorporation documents including
 - 11.1 Certificate of Incorporation.
 - 11.2 Articles of Association.
 - 11.3 Memorandum of Association.
 - 11.4 Minutes of first meeting of Directors
12. Forward minutes of first meeting to Directors.
12. Forward copies of Articles of and Memorandum of Association to nominated

STANDARD SPECIFICATION FOR A TRAFFIC OFFENCE

1. Preliminary interview - charge of dangerous driving against stock agent involving a non-injury collection. Instructed to defend the charge.
2. Attending at Court when information adjourned for a defended hearing.
3. Interviewing defence witness (passer-by) and defendant to prepare a hearing.
4. Speaking to Ministry of Transport to obtain details of prosecution evidence. If necessary, making a request under the Official Information Act 1983.
5. Attending at Court to conduct defended hearing in which traffic officer in charge of prosecution and other driver give evidence for prosecution as well as defendant and passer-by for defendant. Total time involved at Court 1½ hours.
6. Preparing application for limited licence involving affidavits from defendant and employer representative.
7. Attending at Court to obtain limited licence against opposition from Ministry of Transport.