

Australian Price Indexes for Legal Services

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Summary

The legal services price index has recently been developed by the Australian Bureau of Statistics (ABS), with data collected since September quarter 1998. At present a selection of large legal firms is enrolled in the survey, predominantly representing the eastern states. The intention is to extend coverage of the survey to include firms from all Australian States. Commercial, financial and business services are the only services priced in the current index. Prices collected are hourly charge out rates by staff level, for a specified set of conditions (ie, a form of model pricing). This data is generally easily accessible by respondents, thus minimising reporting burden. The industry is undergoing rapid growth and change at present. The ABS must closely monitor firms for changes in structure or activity.

1. Introduction

The Australian Bureau of Statistics (ABS) is undertaking a long-term development program to progressively extend the scope of the producer price indexes into the services sector of the economy.

On 18 April 2000, the ABS launched a new quarterly publication, **Producer Price Indexes for Selected Service Industries, Australia**. This publication presented quarterly price index numbers for most industries within the transport and storage, and property and business services sectors from September quarter 1998 to March quarter 2000.

The Legal Services price index has been compiled on a quarterly basis since the September quarter 1998.

2. Classification/ types of activities

The service industry price index development work is taking place within the classification framework provided by the Australian and New Zealand

Standard Industrial Classification (ANZSIC). Legal services fall within the ANZSIC class 7841.

The legal services price index covers the following main activities:

- barrister
- solicitor
- notary.

A barrister is a legal practitioner whose primary function is to act as an advocate in court. A solicitor is a legal practitioner whose services consist of advising clients, representing them before the lower courts, and preparing cases for barristers to try in the higher courts. A notary is similar to a clerk.

Members of industry bodies are required to have particular qualifications and ongoing professional development, although ANZSIC makes no mention of any minimum professional qualification in its definition.

3. Business Model

Structure of the legal industry

The legal services industry is comprised of solicitor firms, barrister firms and other enterprises whose primary activity is the provision of legal services. Based on 1995-96 statistics, solicitor firms account for more than 65% of the industry, barrister firms for more than 34%, and other enterprises the remaining 1%.

Most legal firms specialise in certain areas of the law. There is a general split between government and private in the industry, amongst both firms and clients. Many legal practices are conducted via a single entity (e.g. a sole practitioner or a partnership), while other practices are conducted via more than one entity (e.g. a legal firm or a service entity). Lawyers in private practice act either as principals or are employed by lawyers acting as principals. A principal is a person authorising another agent to represent him or her.

Solicitors' firms are most commonly sole proprietorships or partnerships, more rarely companies or trusts. The usual personnel structure for solicitors within a firm is:

- senior partner
- partner
- associate partner
- solicitor

- para-legal.

Although the majority of practices are small, with 95% of practices employing fewer than 20 people, these practices account for only 54% of the total employment in legal services, and contribute 46% of the total income of the industry (1995-96 statistics).

Many firms are members of a *federation*, which is a group of people who have an independent operation in each city and share profits amongst the respective members of each group.

Description of services priced

Commercial, financial and business services are the main sources of income in the legal industry, with property conveyancing the second largest. Smaller firms tend to rely on conveyancing, with a trend to a lower proportion of conveyancing services as the firm size increases. At present, commercial, financial and business services are the only services priced. These services are more subject to market forces than other legal services, and there is considerable overlap with services provided by accountants in areas including taxation, and merchant banks in merger and acquisition matters.

The major clients of these legal services are companies, followed by individuals, and non-profit organisations. There are two common types of services in the corporate legal industry:

- wholesale - which deals with large organisations, e.g. acquisitions, mergers, liquidations, business tax consultancy
- retail - which deals with legal wills, property conveyancing, probates, etc.

Wholesale activities forms the bulk of corporate legal work.

The major contracts are from large corporate accounts and government business.

Governmental regulation and ownership/ subsidisation

There are scale fees for legal practitioners set by the courts. These scale fees vary from state to state. Scale fees are guides only, and generally do not represent prices transacted.

The big corporations and some of the federal and state government bodies have their own resident legal employees. The Commonwealth Government has its own organisation which deals with most of the legal requirements for

all Commonwealth agencies. State government agencies compete in the open market and submit tenders for other state government departments' legal work.

Legal Aid is also funded by the Commonwealth and state governments. Legal aid supports disputes that are covered under family or criminal laws, and private legal practices that represent clients are partly covered. Almost 80% of Legal Aid cases are free with the remainder priced far below market rates. Legal Aid services are not covered in the index as yet.

4. Sample design

Considering that the legal industry is widespread across Australia, respondents were chosen on the basis that they have an Australia-wide network or are established locally as a legal expert. Presently there are a selection of large legal firms in the sample, with the index split into two component indexes, commercial and plaintiff.

The legal services price index commenced development in Late 1999, with back data collected to September quarter 1998. This index is not yet fully developed and further investigations need to be undertaken in regard to extending coverage.

To date, rapport has been established with respondents who have been cooperative and the data has been collected without many problems.

5. Industry pricing and record-keeping practices

There are three pricing bases in the legal industry:

- item based pricing: a price is charged for particular parts of the service provided
- time based pricing: some kinds of legal work are charged at an hourly rate which is multiplied by the time taken to provide the service
- ad valorem pricing: the price is a proportion of the value of the subject of the legal work (e.g. the value of a property being conveyed or the amount recovered in court action).

Time based pricing tends to be the most common method of pricing. Solicitors and barristers are free to set their own hourly rates based upon their experience/ expertise, demand, and what the market will bear, provided it is within 15% of the scale fee for court representation.

Solicitors

Solicitor costs are based on the time taken multiplied by the applicable hourly rates, contract or implied contract details, and other costs collectively termed disbursements. An implied contract involves applying the relevant statutory scale fees. Disbursements include fees payable at public offices or public authorities, fees paid to other professionals involved, travel and accommodation expenses and other charges incurred and purchases necessary for the case. For cases which involve court costs, these costs are charged according to fees set by the courts. Hourly rates tend to be the most common method of pricing.

The final price may include unspecified allowances for 'general care and conduct', and take into account factors such as the complexity of the case, specialised knowledge and responsibility, the importance of the matter and the value of the property or money involved. City solicitors generally charge more than country solicitors due to differing costs and specialisation.

Some specific types of fees for solicitors include:

- a) private firms: solicitors charge in 6-minute blocks
- b) blended fee with government clients: Instead of charging separately for different levels of staff and estimating quantities of time per staff level, a blended charge such as an average of hourly rates is estimated
- c) tender for a job: in the tender, hourly rates and estimates of the time required are given
- d) fee agreement: the client sets a maximum amount he/ she wants to spend, and legal proceedings continue until all the money is spent or the client decides to terminate the proceedings
- e) success fee: the client is charged only when the case is won, otherwise there is no charge.

There is not much tendering undertaken in the legal industry, which limits the leverage on prices.

Barristers

There are two common types of pricing among barristers:

- price for briefs with refreshers

- price for time (daily or hourly).

Barristers generally charge daily or hourly rates, and negotiate their fees with solicitors. Additional prices are charged for cancellation and retainership of barristers. All states and territories have their own scale of fees for barristers, covering items such as brief fees and refreshers, chambers work, advice on evidence, conferences, opinions, and interrogatories.

Factors affecting price change

Factors affecting price change include the geographic location, the level of expertise which affects hourly rates and the availability of work which affects demand. Hourly rates are generally reviewed annually by firms and are adjusted in line with wage rises.

There is no standard rate of price increases, and the CPI is not used in determining price changes. The legal industry functions on the basis of supply and demand.

Labour costs per employee tend to increase with practice size, which reflects the different employment mix of the practices. Smaller practices employ generally only support staff, while large practices employ qualified legal staff as well. 1995-96 statistics show a wide variability in income per person between practices. Practices with 100 people or more had incomes 41% above the industry average, while practices with employment of 5-9 people had incomes 22% below the industry average. Barristers in particular have a very wide range of incomes.

6. Publication structure and relationship to the CPC

The Australian legal services index is published at the classification level *Legal services*, which is a sub-classification of *Legal and accounting services* group. *Legal services* is a four-digit ANZSIC class, which corresponds to a three-digit group of the CPC. Legal services in the CPC is broken down into many sub-classes, unlike under ANZSIC.

The CPC has a separate class for 'insolvency and receivership services', in contrast to ANZSIC where these services are not explicitly listed.

ANZSIC	CPC

784 Legal and Accounting Services	
7841 Legal Services	821 Legal Services
	822 Accounting, financial auditing and book-keeping services
	823 Advisory services related to taxation
	824 Insolvency and receivership services

7. Pricing methodology and specifications

Respondents are asked to report a selection of hourly rates by level of staff for a project for a major corporate client. That is, transactions prices are collected. For example, contract prices in hourly rates may be collected for a senior solicitor, graduate solicitor, and partner. This is considered to be close to constant quality pricing and the data is readily available. Where there is reluctance on the part of the solicitor to reveal their cost structure, tendering contracts (if accessible) are a source of hourly rates.

To more comprehensively reflect price changes in the legal industry, this pricing basis should ideally be accompanied by a pricing model for the disbursements. The present method of collecting hourly rates does not include the many other costs which impact upon the final contract price. Initially a detailed model pricing approach was attempted. However it was found that collecting the data for the model was very difficult and that collecting contract prices in terms of hourly rates was more practical for the respondents and adequately reflected price movements. Model pricing is difficult because the mix of staff and factors contributing to each case differ between cases, and throughout the industry there are different bands of legal professionals (ie, the classification of staff differs amongst firms).

8. Technical concerns (pricing difficulties)

The primary technical difficulty in this survey is data availability and defining specifications. Determining price specifications is difficult since inputs for each legal case involves a different mix of professional staff levels. It is often difficult to determine the level of involvement of staff in each case. However, respondents have so far been able to provide common bands of staff levels. Although there are many factors that influence pricing, fees are primarily based on the number of hours spent on a case. Even in fixed contract cases or tenders, hourly rates are worked out before the pricing/ tender is submitted.

The legal services industry is very volatile because it is rapidly growing and changing. This causes difficulties in the collection of information and respondents must be contacted quite frequently to review the specifications, size and structure of the firm. Many respondents are also reluctant to release information to the ABS. Often negotiation is required before the respondents are willing to release contract pricing information.

9. Survey vehicles

Survey development began with background research on the Legal industry and market structure. Personal interviews were conducted with various legal bodies and associations. Judgmental sampling is used - respondents are identified on the basis of whether they are in-scope for the survey and if they are representative of a component index. Respondents are enrolled through a personal interview. The type of specifications for the survey are obtained by interviews with firms. The respondents are scheduled for a personal interview every second year, with mail contact in the intervening year, in order to review the specifications to ensure they remain appropriate.

10. Industry developments

The legal industry is a growing industry, with many independent legal experts joining to form large companies and extending their operations overseas. During the period between June 1993 and June 1996 there was a 15% increase in the number of solicitors' practices and a 5% increase in the number of barristers' practices. In the last 5 years, there has been an increase in the number of national firms. It is projected it may take another ten years before the industry settles down.

The legal fraternity is becoming more demand-driven and competitive. In the year to July 1999, some specialist Sydney lawyers won significant pay increases. There have been pay increases especially for those in the growth areas of corporate law, intellectual property, information technology and banking. However, although there have been increases in solicitor rates, partner rates have mainly been stable. This can be attributed to a present oversupply of lawyers.

Contracts are becoming widespread in some areas of law across Australia. Large law firms which mainly provide services to large corporations and government bodies use contracts extensively for contentious work at rates above the relevant scale.

11. Need for future work

In the future the sample may be extended to cover medium, and possibly small, firms and to better represent all Australian states. The scope of the current legal services index is restricted to business clients and not services provided to householders. Further investigation is required to develop additional specifications in order to extend coverage of the wide range of legal activities undertaken. The sample will also need to take into account effects of geographic location on type of firm, their activities, and prices.

12. Conclusion

The legal services price index has been compiled for almost a year. A sound sample of large legal firms have been established and a basis for specification pricing derived. Only commercial, financial and business services are covered by the survey as the scope is currently restricted to business-to-business activities. The industry will need to be closely watched since it is undergoing significant change and growth, and is heavily affected by supply and demand forces.