Revisited Sector Paper on: ISIC Rev.4 691 Legal activities

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Overview

- Introduction
- Overview of industry
- Classification issues
- International methodological recommendations
- Output/turnover
- SPPI
- Summary
Introduction

- legal activities in the works of Voorburg Group

- Classification of Services of ISIS (89.12+89.13), Netherlands Central Bureau of Statistics– 1987, Stockholm,
- Draft classification of Legal services excluding jurisdiction (ISIS 89.11), Netherlands Central Bureau of Statistics– 1987, Stockholm,
- Australian Price Indexes for Legal Services, David Collins, Australian Bureau of Statistics, 2000, Madrid,
- Legal Services within Producer Price Indexes - The New Zealand Experience, Ron McKenzie, New Zealand, 2000, Madrid,
- Service Price Index for Legal Services, Sima Assaf, Central Bureau of Statistics Israel, 2003, Tokyo;
- PPI for Legal Activity, Auditing and tax Consulting Services in Germany, Astrid Stroh, Susanne Lorenz, Federal Statistical Office Germany, 2004 – Ottawa,
Overview of industry

Two types of legal systems

<table>
<thead>
<tr>
<th>The legal system of continental Europe</th>
<th>The Anglo-Saxon legal system</th>
</tr>
</thead>
<tbody>
<tr>
<td>❑ legal practice follows laws and acts</td>
<td>❑ legal practice bases on precedent cases</td>
</tr>
<tr>
<td>❑ market is more regulated by government than in the Anglo-Saxon countries</td>
<td>❑ fees are usually charged after free price negotiations and sometimes on a success basis</td>
</tr>
<tr>
<td>❑ fees are set on the basis of the scales of fees</td>
<td></td>
</tr>
</tbody>
</table>

However, in all countries there are different regulatory bodies (dependent on or independent from government) such as law societies or bar associations which coordinate the functioning of legal market, requirements necessary for entering the market etc.
Overview of industry c.d.

Types of lawyers

**barrister and solicitors**
- deal with advising their clients in legal matters as well as disputes and their representation in court of law and other legal institutions;
- most of them specialize in the given activity fields such as civil, commercial, criminal, family, fiscal, insurance, labor, renting law etc.;

**notaries**
- the next group of lawyers which are responsible for stating legal situations in the field of family, company and real estate rights such as real estate contracts, partner inscription in company register etc.

**patent attorneys**
- which represent their clients in obtaining patents for innovative products or services and protecting the products or services from competitors' patents until the prolongation of a patent.

**bailiffs, arbiters and mediators**
Overview of industry c.d.
– business model of legal industry

- in most countries is a small number of large firms to be involved in providing a range of services to corporate clients, and a much larger number of small firms (usually in the form of a sole proprietor or partnership) servicing households and small business needs;
- small units with the number of persons employed 9 and less constitute – from at least 58% to above 90% of total number of units (VG questionnaire);
- the legal advisory and representation services were most often mentioned by countries as a main source of turnover from legal services (VG questionnaire);
- in the aspects of globalization, the market of legal services develops steadily;
- the demand for legal services is driven mainly by “the increasing legal requirements of corporation”;
- general tendency for smaller units to merge in order to achieve better economy of scale, or to enter into strategic alliances with other small unit;
- even during the global crisis the legal companies proved to be flexible and were able to make profits from their activity;

Classification issues

Legal activities in industry classifications

- ISIC Rev.4 69.1 Legal activities
  - NACE Rev.2 69.1 Legal activities
    - NAICS 2007 5411 Legal services
      - NAICS 2007 54111 Offices of Lawyers
      - NAICS 2007 54112 Offices of Notaries
      - NAICS 2007 541191 Title Abstract and Settlement Offices Services
      - NAICS 2007 541199 All Other legal services
    - NAICS 2007 541199 All Other legal services
  - NAICS 2007 541199 All Other legal services
  - ANZSIC 2006 6931 Legal services
## Classification issues

**Legal activities in product classifications**

<table>
<thead>
<tr>
<th>CPC Ver. 2</th>
<th>CPA2008</th>
<th>NACPS for NAICS</th>
<th>Products for ANZSIC 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>82.1</td>
<td>Legal services</td>
<td>69.1/69.10/69.10.1</td>
<td>Legal services</td>
</tr>
<tr>
<td>8211</td>
<td>Legal advisory and representation services concerning criminal law</td>
<td>69.10.11</td>
<td>Legal advisory and representation services concerning criminal law</td>
</tr>
<tr>
<td>8212</td>
<td>Legal advisory and representation services concerning other fields of law</td>
<td>69.10.12</td>
<td>Legal advisory and representation services in judicial procedures concerning business and commercial law</td>
</tr>
<tr>
<td></td>
<td></td>
<td>69.10.13</td>
<td>Legal advisory and representation services in judicial procedures concerning labour law</td>
</tr>
<tr>
<td></td>
<td></td>
<td>69.10.14</td>
<td>Legal advisory and representation services in judicial procedures concerning civil law</td>
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</tbody>
</table>
## Classification issues
### Legal activities in product classifications

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<th>NACPS for NAICS</th>
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</thead>
<tbody>
<tr>
<td>8213</td>
<td>Legal documentation and certification services</td>
<td>69.10.15</td>
<td>Legal services concerning patents, copyrights and other intellectual property rights</td>
</tr>
<tr>
<td>8213</td>
<td>69.10.16</td>
<td>Notarial services</td>
<td></td>
</tr>
<tr>
<td>8219</td>
<td>Other legal services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>82191</td>
<td>Arbitration and conciliation services</td>
<td>69.10.17</td>
<td>Arbitration and conciliation services</td>
</tr>
<tr>
<td>82199</td>
<td>Other legal services n.e.c</td>
<td>69.10.18</td>
<td>Auction legal services</td>
</tr>
<tr>
<td>82199</td>
<td>69.10.19</td>
<td>Other legal services</td>
<td></td>
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</tbody>
</table>
International methodological recommendations

Compilation Manual for an Index of Service Production
OECD, 2007

Methodological Guide For Developing Producer Price Indices For Services
OECD, 2005

Handbook on price and volume measures in national accounts
Eurostat, 2001
International methodological recommendations

Compilation Manual for an Index of Service Production
OECD, 2007

indicates variables for measuring the output of legal activities

- the best variable
  - gross turnover deflated by appropriate quality adjusted price indices
    - CPI for legal services
    - PPI for legal services

- the alternative variable
  - gross turnover deflated by partially representative price index
    - PPI partially representative for legal services
    - volume indicators
    - general price index
    - CPI
International methodological recommendations

Methodological Guide For Developing Producer Price Indices For Services
OECD, 2005

- describes more comprehensively pricing mechanisms used for charging fees and methods of their statistical observation

Pricing mechanisms applied in case of

freely contracted fees

scales of fees
International methodological recommendations

Methodological Guide For Developing Producer Price Indices For Services
OECD, 2005

Pricing mechanisms applied in case of freely contracted fees

<table>
<thead>
<tr>
<th>Pricing mechanisms</th>
<th>Pricing methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charge-out rates (hourly rates)</td>
<td>Hourly charge-out rates</td>
</tr>
<tr>
<td>Ad valorem prices</td>
<td>Percentage fee method</td>
</tr>
<tr>
<td>Flat rates</td>
<td>Percentage fee method</td>
</tr>
<tr>
<td>Success-correlated fees</td>
<td>Model pricing</td>
</tr>
</tbody>
</table>
International methodological recommendations

Methodological Guide For Developing Producer Price Indices For Services
OECD, 2005

Pricing mechanisms applied in case of scales of fees

<table>
<thead>
<tr>
<th>Pricing mechanisms</th>
<th>Pricing methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed fees</td>
<td>Hourly charge-out rates</td>
</tr>
<tr>
<td>Ad valorem prices</td>
<td>Percentage fee method</td>
</tr>
</tbody>
</table>
International methodological recommendations

Methodological Guide For Developing Producer Price Indices For Services OECD, 2005

Pricing methods

- Hourly charge-out rates
- Percentage fee method
- Model pricing

- Fixed fee
- Ad valorem prices
International methodological recommendations

*Handbook on price and volume measures in national accounts*
*Eurostat, 2001*

- provides us with information on the best method for compiling the price indices regarding the type of legal service and customer

<table>
<thead>
<tr>
<th>Type of legal service</th>
<th>Client</th>
<th>Pricing mechanism</th>
<th>Pricing method</th>
<th>Method A/B/C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drawing up the contracts for buying houses, wills, marriage contracts et. – “notary” services</td>
<td>households</td>
<td>Most often - fixed tariffs</td>
<td>CPI</td>
<td>A</td>
</tr>
<tr>
<td>Legal services related to gross fixed capital formation being part of transfer costs of buying property</td>
<td>households and businesses</td>
<td>Fee is related to with the price of property</td>
<td>Percentage fee method</td>
<td>B</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fixed fee</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Direct use of prices of repeated services</td>
<td>B</td>
</tr>
<tr>
<td>Other services to businesses</td>
<td>businesses</td>
<td>Total fee = hourly rate*number of hours</td>
<td>Charge-out rates</td>
<td>B</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fixed-rate on the basis of contact</td>
<td>Contract pricing</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Model pricing</td>
<td>A</td>
</tr>
</tbody>
</table>
Output/turnover

Variables reflecting the output of legal activities

- revenue
- turnover
- receipts
- production value
- sales of own goods and services
- value added at the factor costs
Output/turnover – interview

Turnover at industry level

*Frequency and number of countries which compile data on turnover at the industry level for legal activities - 20 respondents*

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Number of countries</th>
<th>Data source</th>
</tr>
</thead>
<tbody>
<tr>
<td>annually</td>
<td>18</td>
<td>census, sample survey, administrative data</td>
</tr>
<tr>
<td>quarterly</td>
<td>6</td>
<td>sample survey, administrative data</td>
</tr>
<tr>
<td>monthly</td>
<td>8</td>
<td>administrative data</td>
</tr>
<tr>
<td>with other frequency- every five years</td>
<td>1</td>
<td>census</td>
</tr>
<tr>
<td>with other frequency- every two months</td>
<td>1</td>
<td>administrative data</td>
</tr>
</tbody>
</table>
## Output/turnover - interview

### Turnover at product level

*Frequency and number of countries which compile data on turnover at the product level for legal activities - 20 respondents*

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Number of countries</th>
<th>Data source</th>
</tr>
</thead>
<tbody>
<tr>
<td>annually</td>
<td>9</td>
<td>sample survey, administrative data</td>
</tr>
<tr>
<td>biennally</td>
<td>5</td>
<td>sample survey</td>
</tr>
<tr>
<td>with other frequency – every five years</td>
<td>1</td>
<td>census</td>
</tr>
</tbody>
</table>
Output/turnover – challenges

- Decreasing and effective managing the respondent burden which mainly results from obligation for delivering data on turnover by product;

- The way of counting the establishments - every lawyer working at a law firm which does not have corporate status should be counted as one establishment respectively, but the law firm is sometimes counted as one establishment regardless of the number of lawyer in the business frame;

- Difficulties in proper measuring the output of legal activities due to the different ways of establishing prices in the industry;

- Meeting the legal requirements and user needs;

- Difficulties in selecting appropriate samples of surveys in order to adequately reflect output and profit levels.

- The environment of legal professionals - strong lobby that is resistant to providing statistical information;
Output/turnover – recommendations

Based on information surpassed by various countries it can be stated that:

- the variable which in the best way reflects the output of legal industry is turnover;
- it is highly recommended to compile data on turnover at the industry as well as at the product level;

Annual information on turnover for legal activities at the industry level present changes in values and allow to assess the growth of all legal services sector while data on turnover at the product level show phenomena which take place inside the industry. Moreover, data on turnover by product are applied while constructing the SPPI for legal services.

- in order to make more depth insight into the legal industry it is helpful to analyze short-term data on turnover (turnover indices) which reveal the trends and cycles specific for legal industry.
Service Producer Price Indices (SPPI)

- 15 countries have developed an SPPI for Legal Activities - Australia, Austria, Finland, France, Germany, Ireland, Israel, Japan, Netherlands, New Zealand, Norway, Spain, Sweden, United States, and Slovenia.

- Main pricing method used - time based method based on hourly charge out rates.
  - Collected with assumption that changes in hourly charge-out rates will approximate changes in the final charges paid by clients.
  - Respondents may provide a selection of hourly charge-out rates for a specific type of project that is representative of the firms activities.
  - Hourly charge-out rates provided by firms are often collected by level of staff/qualification category.

- Model pricing and contract pricing are also quite common.
## SPPI – Hourly Charge-out rates

<table>
<thead>
<tr>
<th>Country</th>
<th>Use of hourly charge-out rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>Construct models based on previous billing invoices. Where the invoice specifies the charges of individual legal professionals, each of these rates are updated in future periods.</td>
</tr>
<tr>
<td>Australia</td>
<td>Collect a selection of hourly charge out rates by staff level, for a project for a major client.</td>
</tr>
<tr>
<td>Japan</td>
<td>Monitors monthly or hourly fees for attorney services (covering advisory services only).</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Conducting a pilot survey. Collect standard hourly charge out rates along with the hours billed and the total fees billed during the quarter. The ratio between what was actually billed for the hours and what would have been billed had the standard rates been charged is used to adjust the standard rates.</td>
</tr>
</tbody>
</table>
## SPPI – Other pricing methods

- Time based pricing method usually supplemented with other methods - contract pricing or model pricing.
- Different pricing mechanisms tend to be used for different types of work.

<table>
<thead>
<tr>
<th>Country</th>
<th>Pricing method</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>New Zealand</strong></td>
<td>Model pricing.</td>
</tr>
<tr>
<td><strong>United States</strong></td>
<td>Collect fixed fees for real estate transactions, simple divorces, simple wills etc. Models pricing - where a contingency fee is charged, respondents estimate the dollar value of the settlement/penalty would receive if the case were taken again.</td>
</tr>
<tr>
<td><strong>Israel</strong></td>
<td>Re-price fixed fees. Collect contract fees.</td>
</tr>
<tr>
<td><strong>Austria, Germany and France</strong></td>
<td>Monitor fees set by industry regulators.</td>
</tr>
<tr>
<td><strong>Japan</strong></td>
<td>Track different types of registration fees.</td>
</tr>
</tbody>
</table>
SPPI – Issues

- Main concerns relate to the use of hourly charge out rates:
  - Labour productivity
  - Other components contribute to the final cost of the service
  - Charge-out rates can remain constant whereas the true price of the service is increasing
  - As staff gain experience and their skills improve the quality of the services they provide will change
  - Legal firms often change their mix of staff
SPPI – Issues

- Difficulties experienced with model pricing:
  - Countries experienced difficulties implementing
  - The mix of staff and factors contributing to each case differs
  - In practice respondents may not change the listed inputs

- New Zealand investigated the validity of using charge-out rates:
  - Some short-term differences in the index series,
  - Over medium to long-term differences were not as large as expected
SPPI – Other Considerations

- Majority of countries collect their information via survey
- Most countries collect data quarterly
- 14 countries publish their results
- Main challenges highlighted by countries include:
  - Reluctance from respondents/other associations to provide assistance
  - Industry is very dynamic
  - Response burden and costs are key challenges for many countries.
# SPPI – Recommendations

<table>
<thead>
<tr>
<th>Pricing methods</th>
<th>Category</th>
<th>Information</th>
<th>Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed fee</strong></td>
<td>A method</td>
<td>- Used for routine legal work&lt;br&gt;- Supplements hourly rates&lt;br&gt;- Low cost / effective in pricing to constant quality</td>
<td>- Only covers a small part of the industry&lt;br&gt;- Rarely get repeated constant quality services</td>
</tr>
<tr>
<td><strong>Contract pricing</strong></td>
<td>A method</td>
<td>- Monitor rate paid according to a long term contract&lt;br&gt;- Supplements hourly rates</td>
<td>- Only covers a small part of the industry&lt;br&gt;- Difficult to measure a constant quality service</td>
</tr>
<tr>
<td><strong>Hourly charge-out rates</strong></td>
<td>B Method</td>
<td>- Favoured by many countries&lt;br&gt;- Readily available / easy for firms to provide&lt;br&gt;- Reflects price changes&lt;br&gt;- Easier and low cost</td>
<td>- Labour productivity&lt;br&gt;- Excludes other costs&lt;br&gt;- Charge-out rates can remain constant whereas the true price may be increasing</td>
</tr>
<tr>
<td><strong>Model pricing</strong></td>
<td>C Method</td>
<td>- Specifications developed in consultation with legal professionals&lt;br&gt;- Supplements hourly rates</td>
<td>- Defining specifications is difficult&lt;br&gt;- Periodic updating is time-consuming and costly&lt;br&gt;- Costs for respondents in terms of reporting time&lt;br&gt;- Countries experienced difficulties with this method</td>
</tr>
</tbody>
</table>
Summary

1) The market of legal services more regulated by government in continental Europe than in the Anglo-Saxon countries - influence on pricing mechanisms and pricing methods

2) The stable growth of legal industry mainly due to the demand for legal services driven by “the increasing legal requirements of corporation”

3) A common feature of the legal industry in most countries: small number of large firms providing a range of services to corporate clients, and a much larger number of small firms servicing households and small business needs

4) The gross turnover deflated by appropriate quality adjusted price indices (CPI or PPI for legal services depending on the type of consumer.) as the best variable for measuring the output of legal activities

5) Data on turnover at the industry level as well as at the product level – produced by the vast majority of countries

6) Broader usage of administrative data, especially VAT data, for compiling data on turnover

7) Cooperation with professional bodies, such as law societies and bar associations - strongly recommended
Summary

8) Hourly charge out rates
   - easier and low cost compared to other methods

9) Model pricing difficult to implement
   - time-consuming / response burden

10) Data collected mostly via survey
    - some from administrative data.

11) Main challenges:
    - reluctance from respondents
    - uniqueness of service
    - different pricing mechanisms used for different services;
    - response burden and costs