# "IS THE LEGAL SYSTEM AN EFFICIENT REGULATORY AND DISPUTE RESOLUTION DEVICE?"

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## 1. INTRODUCTION[1]

The basic idea underlying this paper is that:

> *the legal system is a mechanism for the resolution of disputes and the means by which much of the regulation of activity is implemented. It is producing a service. Is it efficient?*

As economists, we frequently describe the rationale for government intervention as being based on three criteria being met:

1. outcomes in a non-intervention situation are unsatisfactory
2. interventions are available which can improve outcomes
3. these intervention strategies will be properly applied

We could consider the legal system as an intervention which, we hope, will improve on non-intervention outcomes. It should not be assumed that this improvement occurs, that the system is performing as well as it could, or that there are no better alternative interventions.

From an economist's perspective, the system should be evaluated and monitored to assess whether it is operating beneficially and whether its operation could be improved. On occasion, other alternative methods of intervention should be considered. It may be that the evaluative criteria set by lawyers do not coincide with the

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[1] Centre for Public Policy Evaluation, Massey University, Palmerston North, New Zealand. Versions of this paper have been presented at the Australian Law and Economics Society Conference, Melbourne, Australia, July 1997 and the New Zealand Association of Economists Conference, August 1997.

criteria which economists would select[2] and alternative approaches may not get due consideration[3,4].

This paper will focus primarily on issues within the legal system, rather than alternative approaches. Unless otherwise stated, named laws are those which apply in New Zealand.

## 2. EVALUATION CRITERIA

There are several components which could be included in an economic evaluation of an activity or policy. All assessments require some specification of objectives, plus consideration of the processes involved in their achievement. Theoretical considerations play a part in determining the variables to consider and how they interact with each other, and there are issues of measurement and possibly of valuation of inputs and outputs.

### 2.1 General criteria

When economists consider evaluation of policies, there are certain questions/issues which could be addressed.

#### 2.1.1 Efficiency

The economists' meaning of efficiency is important to any evaluation. Studies of efficiency can be done at various levels. Efficient production involves achieving the maximum output for a given cost or achieving a given output at a minimum cost. This is the sort of efficiency considered in cost-effectiveness analysis (CEA).

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2 Legal criteria should not be overlooked, although the purpose of this paper is to emphasise the economics perspective.

3 In the medical area funding of research by pharmaceutical companies might have lead to a relatively large emphasis on drugs as a basis for treatment.

4 See 3.3.6 for a discussion on mediation as an alternative approach.

Allocative efficiency goes further in that it considers the determination of appropriate output levels and the allocation of output over end-users. This is considered in cost-utility and cost benefit analyses (CUA and CBA).

According to Heyne[5], if efficiency is to have a useful meaning, it must be understood as the ratio of one thing to another. Further, efficiency is an evaluative term and much obviously depends on how we value output and input. Engineers might build the most efficient steam locomotive in the world, but changes in the price of coal or wood could instantly render the locomotive inefficient. Main and Baird[6] state that an efficient method of production provides a given benefit at the lowest possible cost or provides the most benefit for a given cost.

We can also consider the processes, as with an analysis of market structure. Here we combine the cost-effectiveness and market structure aproaches.

For the purposes of this paper, we shall break down the production process into three components. 1) What outcomes is the government trying to achieve? 2) What is the structure for achieving those outcomes? 3) What controls are applied to ensure the structure works as intended?

Applying this perspective to the legal system, we are concerned with the following areas:

1. The existing laws are what have to be applied.

Are the laws efficiently framed? A law is designed to give a particular outcome, but is the law framed to do this at the least

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5 Page 120 of Heyne P (1987) *The Economic Way of Thinking*, 5th edition, New York: Macmillan.

6 Page 29 of Main R S and Baird C w (1981) *Elements of Economics*, 2nd edition, New York: West Publishing.

possible cost? Often the title of a law is stating what it intends to do. For example, the Matrimonial Property Act (MPA) is aimed at achieving an equitable division of property. Is the MPA appropriately stated to achieve this efficiently?

2. The legal system is the structure we have for applying the laws.

Given existing laws, does the system work as intended, even given that participants follow the rules? Monitoring systems are needed to provide information to answer this question.

3. Incentives and sanctions are the procedures to ensure that people behave appropriately within the structure.

Are there suitable incentives and/or control mechanisms (monitoring and sanctions) to ensure that participants follow the rules?

Evaluation must include the measurement (and possibly valuation) of output. In this paper we are considering economic issues, rather than undertaking evaluations, but there are significant problems when it comes to evaluating services. For example, should the output of the legal system be measured in terms of cases handled, or disputes resolved, or should some account be taken of complexity or quality? What about the broader implications for the parties involved (i.e. "outcomes", rather than "outputs")?[7]

### 2.1.2 Equity

Not to be confused with equality, equity refers to "fairness", which might involve consideration of the different circumstances or

[7] These difficulties are well known to economists. Many government outputs are services which are not sold and thus do not command a market price (often it is difficult to identify the actual output). In the GDP accounts, the value of the output of say a probation officer is measured by the only price we have, which is the value of the inputs. Hence a probation officer would be valued by her salary.

attributes of the parties concerned. It is in fact a very complex concept, particularly because it involves interpersonal comparisons as well as assessments of nebulous concepts such as "wellbeing" (or "utility"). It is sometime side-stepped in welfare economics through use of the Pareto Optimality criterion (which allows no interpersonal comparison), and the Kaldor-Hicks compensation principle[8]. We will not go into detail on this aspect here.

## 2.2 Outline of the Approach in the Health Sector

The health sector in New Zealand has undergone sweeping reforms in recent years[9]. Major changes include the purchaser-provider split, the move from Area Health Boards to Regional Health Authorities (RHAs), hospitals to Crown Health Enterprises (CHEs), capped budgets for RHAs, the contracting out of health care services, the use of branches of Cost-utility analysis (CUA), attempts at defining core health services as well as a review of the system sanctioning health professions. All of these changes are interrelated, but we comment briefly on a few of the topics.

### 2.2.1 Accountability and Responsiveness

This is an emphasis on accountability and responsiveness of purchasers and providers. Purchasers of health care services are seen to be responsible to the whole population. Accountability means that an agent provides a service which meets the requirements of the

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[8] This simply considers that a change is acceptable if all the losers from a change could have been compensated by the gainers, so that no one loses. While questionable, this principle underpins cost-benefit analysis.

[9] Economists generally consider intervention to be a possible response to market failure. Several types of market failure with special attention to health are described in Birks S "Economic Issues I: Governments and Markets", pages 20-33 of North H (1992) *Health Reforms and the Workforce: Responses and Options*, Occasional Papers 1992 Number 2, Department of Management Systems, Massey University, and Buurman G "Economic Issues II: Economics and Health: Health Care as a Special Case", *ibid* pages 34-54.

principal in the contract. Accountability is assumed to result from the contractual arrangement. Responsiveness of the health system is viewed as arising from community consultation, and from competition from various providers of health care[10].

### 2.2.2 The Purchaser-Provider Split

This is a key element in the reforms. Previously, under the Area Health Boards, purchasers and providers were grouped together. For example a hospital provided care and also paid its employees from government funds. Of course, the employees had a say in the running of the hospital. This system was seen as potential wasteful in that health care might not be provided at the lowest possible cost.

### 2.2.3 Capped Budgets and Contracting Out

RHAs receive a fixed budget from the government. The purchaser-provider split encourages competitive tendering in the process of contracting out. There are obvious points as to why this would be more efficient than the previous system. In an economic sense, we would expect the benefit- cost ratio of particular treatments to increase. To quote North[11], *"For example, given the large salary differential between nurses as a group, and medical practitioners as a group, RHAs may choose to purchase nursing services for specified services that nurses do as well or better than their medical counterparts."* However balanced against this, it is worth bearing in mind the cost of preparing and enforcing contracts and any possible losses in sale or repurchase of state owned capital equipment.

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[10] See page 72 of Cheyne C, "Social Equity and the Health Reforms", pages 62-82 in North (1992).

[11] Page 12 of North N, "Aspects of Health reforms as they Affect the Workforce", pages 2-19 of North (1992). See also page 41 of Minister of Health (1991) *Your Health and the Public Health*, Government Policy Statement, Minister, Wellington.

### 2.2.4 Cost Sharing or User Part-charges

Charging for health care is seen as a way of addressing incorrect price signals given under the previous system. In 1991 the Minister of Health pointed to the "bizarre mixture of subsidies" affecting the pattern of use of health care services[12]. The previous system was also seen to encourage cost shifting, as in the definition of a person's problem as an accident, in order to affect payment through the Accident Compensation Commission (ACC). Thus cost-sharing is seen as an attempt to allocate costs to users, regardless of where the health care service is provided. In addition, efficiency is promoted by encouraging people to see their general practitioner, rather than seeking free 'out-of-pocket' care at a hospital. User charges will also reduce health care consumption (given a downward sloping demand curve for health care) as well as educate the population regarding the cost of particular treatments.

### 2.2.5 The Core Debate

Discussion on what should be included in the core health services is an attempt at responsiveness (through seeking the community's views through various submissions). Core health services should be available to everyone on an affordable basis without a long waiting time. Core services are delivered through RHAs.

### 2.2.6 CUA and Quality-Adjusted-Life-Years (QALYS)

The problems of valuing the benefits of various health care treatments are well known. Again difficulties arise because many treatments are publicly provided and are not sold in markets. Despite these difficulties (both methodological and practical), such measures are needed for efficient resource allocation decisions in the health care area[13]. CUA has been developed as a measure of health care

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12 *Your Health and the Public Health* (p. 14).

13 See page 118 of Drummond M, "Output Measurement for Resource Allocation Decisions in Health Care", in McGuire A, Fenn P and

benefits. In CUA, benefits are not valued by their prices, but by the quality-adjusted-life-year (QALY). The QALY combines data from the utility of health states, obtained from surveying individuals, with data on life expectancy. Thus we have a measure incorporating both the quantity and quality of life[14]. While there is vigorous debate as to whether this measure should be used (some groups may not be treated, doubt as to the accuracy of survey data, which groups to include, etc.), the advantage is that the QALY is a single measure of output, and given general agreement on its measure, treatments can be compared in terms of cost per QALY. Hence treatments can be administered efficiently in an economic sense. Previous measures of health service output were not ideal. At the national level, health systems had been judged on life expectancies and/or infant mortality. On a micro level, output has been measured as cases treated, or days of care provided, or hospital bed days, etc.[15].

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Mayhew K (eds) (1994) *Providing Health Care: The Economics of Alternative Systems*, Oxford: OUP.

[14] Drummond *op. cit.*, page 101.

[15] In a similar vein, Hadorn D C and Holmes A C (11 January 1997, "The New Zealand priority criteria project. Part I: Overview" *British Medical Journal* No. 7074, Volume 314) reported that New Zealand has established a committee to advise on the kinds, and relative priorities, of health services that should be publicly funded. One project (using a modified Delphi technique) was to develop standardised criteria to assess the expected benefit from elective surgical procedures. Professional advisory groups have helped in devising the criteria for surgery in five areas so far. The upshot is, for example, that a patient could only expect surgery at the taxpayer's expense if their clinical circumstances were commensurate with the likelihood of substantial benefit from the procedure.

### 2.2.7 Review of Occupational Regulations

The Ministry of Heath in New Zealand is undertaking a review of occupational regulation and legislation[16]. This is because many of the health occupational statutes are either out of date, or do not meet the needs of either the profession or the consumer. The intent is to increase the accountability of the profession through tightening up on sanctions.

### 2.2.8 Summary

We can view the health system from the 'general perspective' set out above:

i. Health care services (or we might specify the 'core') are what have to be applied. The purpose of health care services is to increase the health status of patients. Specification of a core of treatments is an attempt to increase health status at least cost. The movement towards CUA based measures of specific health care treatments is an obvious attempt to achieve efficiency through trying to maximise utility per dollar spent on specific treatments. As stated, core treatments are to be affordable to the patient, available to all sectors of the population without undue waiting time. However, in health, there are alternative treatments for a given illness.

ii. The health system is the structure we have for applying health care services. But given existing treatments, does the health system work efficiently even if participants follow the rules? Here reforms of note have been: the spread of user part-charges; the emphasis on accountability and responsiveness; the purchaser-provider split; capping the budgets of RHAs; and contracting out.

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[16] See the speech by Hon Katherine O'Regan, Associate Minister of Health, to the 1996 National Conference of Psychologists Registration Boards of Australia and New Zealand, 29 August 1996 at: http://www.executive.govt.nz/93-96/minister/oregan/kos2908.htm

iii. Incentives and sanctions have also undergone major changes in the health system (to ensure that participants behave appropriately within the structure). The recently announced review of occupational regulations is notable.

## 3. THE LEGAL SYSTEM

In this section we address the issue of the economic nature of service provision in the legal sector. There is a general introduction to the topic in 3.1, with specific issues considered subsequently. 3.2-3.4 consider the three aspects of the perspective outlined in 2.1.1. 3.2 looks at efficiency aspects of the way laws are specified. 3.3 considers how well the legal system might operate to apply the laws, assuming that participants "play by the rules". 3.4 covers professional behaviour and its regulation.

There has been some discussion of these issues (efficiency, etc.) on the ozlec email list in relation to the Resource Management Act. We will focus on the family law area because issues of cost and time are likely to be particularly crucial there, and because of the greater "informality" of the approach. Nevertheless, many of the issues and questions apply equally in other areas of law.

### 3.1 General Discussion

Workers in the legal system are collectively providing a service. For example we could consider the output of the Family Court as the resolution of a dispute between the parties. From this perspective we can consider such things as the nature of the product, how it is produced, whether there is competition, how demand is determined, and so on. There are several interesting aspects to this. The production involves the participation of several service suppliers independently appointed, some funded privately and some publicly, with production being on the instructions of parties who may not be very cooperative. The decision to purchase can be determined by one

party, then requiring outlays by another. When someone initially decides to purchase, it is unclear what the end product will be or what the total cost will be (this is similar to the case with some health care purchases). The benefits of an outlay may not even be clear after purchase, as with "credence goods". While a party has some choice about his or her own counsel, there is relatively little say afforded in the choice of other professionals involved, including the judge.

Consumers are infrequent purchasers of the services of the legal sector and often have limited information about what is being purchased. As with visits to doctors, there are principal-agent problems in that people are buying the expertise of legal professionals and are not fully informed themselves. There is limited scope to insure against the costs of legal services, and limited redress in most cases of "legal misadventure".

If we consider the specification of laws as the governmental implementation of policy in the legal sector, then the government does not have full control over outcomes. A parallel can be drawn with other areas of policy. For example with open market operations in monetary policy, a change can be made in the volume of high powered money (or primary liquidity in New Zealand), but the impact on money supply or interest rates will depend on the response of the trading banks and others.

Considering the legal sector as a whole, there is limited monitoring and there is little in the way of formal economic evaluation of the legal system. Monitoring and evaluation should ideally also extend to the broader implications, including enforcement issues and incentive and disincentive effects on others. These matters are not discussed here.

### 3.2 Efficiency of the Laws

The way a law is specified may have an impact on the efficiency of the legal system. Consider, for example, the Matrimonial Property Act 1976 (MPA).

The title of the Act includes the statement that it is intended *"to recognise the equal contribution of husband and wife to the marriage partnership"*.

This is the basis for the presumption of a 50-50 split of matrimonial property. There are circumstances under which the contributions might not be considered equal, in which case an unequal division is possible. Difficulties can arise in relation to the definition of matrimonial property and the frequently related issue of unequal division of matrimonial property.

In the parliamentary debate leading to the passing of the Act, Mr McLay strenuously denied *"an irresponsible suggestion is that the Bill in some way represents a 'confiscation of property'"* [17]. He went on to say that the purpose of the legislation was to give:

> *"a just and proper apportionment … of … the working capital of the marriage partnership … and I underline the words 'marriage partnership', in contrast, for example, with formal gifts or investments brought to the marriage by one partner or the other, or achieved by incomes ranging well outside normal family needs."*[18]

This is not how the MPA has been interpreted in practice. For example, superannuation entitlements arising from contributions made before marriage are considered to be matrimonial property and are commonly equally split.

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17 *New Zealand Parliamentary Debates*, vol. 408, page 4721

18 *New Zealand Parliamentary Debates*, vol. 408, page 4722

Similarly, Mr McLay had also said earlier when reporting back from the Statutes Revision Committee:

*"Separate property, in addition to those assets which are not otherwise defined as matrimonial property, will also include property acquired by one spouse by succession, survivorship, as a beneficiary; under a trust, or by gift, unless, with the consent of the spouse who received it that property has become so intermingled with other matrimonial property as to make it unreasonable or impracticable to continue to regard it as separate property."*[19]

Nevertheless, there has been confusion as to whether section 8c of the Matrimonial Property Act prevails over section 10. Matrimonial property according to Section 8 (c) includes *"All property owned jointly or in common in equal shares by the husband and the wife"*. Section 10 states that it is separate property if, for example it is, *"acquired by succession or by survivorship or as a beneficiary under a trust or by gift from a third person"*.

Section 10 is consistent with Mr McLay's statement above, but the ambiguity in the wording of the legislation itself has led to several court cases. *Z v Z* and *Cawte v Cawte*[20] resulted in decisions in favour of disputed assets being separate property, but more recently Judge Williams ruled otherwise in *Lewis v Lewis*[21].

These examples are to illustrate that the law may not always be applied as intended, and that ambiguities in the law can lead to expensive disputes.

Dissatisfaction with the interpretation of sections of the Matrimonial Property Act defining matrimonial property are resulting in a demand for pre-nuptial agreements or the establishment of trusts. As one Family Court lawyer stated:

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19 *New Zealand Parliamentary Debates*, vol. 408, page 4109

20 *Z v Z* (1988) 5 NZFLR 111 and *Cawte v Cawte* (1989) 5 FRNZ 773.

21 *Lewis v Lewis* (1993) NZLR 569.

*"A pre-nuptial agreement or a trust is a wise investment for a couple in the following situations:*

- *Where they both have substantial assets.*
- *Where there is a large difference between the assets they are taking into the marriage.*
- *Where they each own a house, but only one is intended to be the family home.*
- *Where one of them expects a large inheritance or gift.*
- *Where one of the intending spouses has intricate financial arrangements with third parties."*[22]

There is expense involved in these arrangements, and there is no guarantee that the outcomes will be as desired. Pre-nuptial agreements can be set aside[23] and trusts can result in unwanted restrictions or obligations. There are also costs involved in establishing and managing these structures.

An alternative approach in taken in the Ontario legislation (see appendix 1). To simplify, it is based on a concept of "net matrimonial property". This consists of matrimonial property at the end of the marriage, less what each person brought in to the marriage from outside, such as at the start of the marriage, or later through

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[22] From p7 of "In Business", "About the Law - Tie the knot securely" by Martin Wall, *Evening Standard*, February 3 1997

[23] Under section 21.8.b: *"(8) An agreement under this section shall be void in any case where-- … (b) The Court is satisfied that it would be unjust to give effect to the agreement."* and section 21.10: *"(10) In deciding whether it would be unjust to give effect to an agreement under this section the Court shall have regard to:*

*(a) The provisions of the agreement:*
*(b) The time that has elapsed since the agreement was entered into:*
*(c) Whether the agreement was unfair or unreasonable in the light of all the circumstances at the time it was entered into:*
*(d) Whether the agreement has become unfair or unreasonable in the light of any changes in circumstances since it was entered into (whether or not those changes were foreseen by the parties):*
*(e) Any other matters that the Court considers relevant."*

gifts and inheritance. This approach appears to fit with the intent of the New Zealand legislation, while greatly reducing the need for people to protect themselves with agreements and trusts. By resolving many of the situations where contributions are clearly unequal, it also reduces the scope for expensive legal disputes. It would appear that this approach is likely to lead to a more efficient resolution of matrimonial property disputes both in terms of the lower litigation costs and in terms of the quality of the outcome.

To summarise, by considering the costs of dispute resolution and the areas of dispute, it may be possible to devise more efficient laws.

## 3.3 Efficiency of the System if it Works as Planned, Given the Laws

In this section we consider how the legal system might operate if participants act according to the rules laid down.

### 3.3.1 A Principal-Agent Relationship

The purchasers buy legal services directly as part of the process of resolving the dispute through the application of law. As the purchase is essentially of expertise, there are principal-agent issues with the principal relying on the agent for information to guide the purchase decision. In this respect there are parallels with the patient-doctor relationship. The efficiency of the relationship and the advice given will depend partly on the ability of the principal to monitor the agent and to understand the process overall (the ability of the principal to adequately supervise the agent), and partly on the incentive structure faced by the agent (will the agent operate appropriately without close, informed supervision by the principal?). The latter would depend on professional ethics and the agent's accurate understanding of the principal's wishes.

Is there effective competition in the supply of legal advice?[24] People can choose which lawyer to use. However, purchases of legal services are infrequent and there can be costs involved in transferring from one lawyer to another. There is limited information available about which lawyer would be most suitable.

Some indication of women's experiences with lawyers is provided in a Law Commission consultation paper[25]. Quotes from submissions include:

*"... the often condescending attitude of the young lawyer ... Many women feel that they are treated as 'simpletons' and their comments and requests are often ignored ... many women feel a decision is often reached in the back room and the woman has no input into the outcome."* (p.1)

*"When I went to see a lawyer he kept talking in big words that I couldn't understand. I left his office not even knowing what he had said to me."* (p.15)

*"My solicitor told me that my costs would be between $600-$2000 initially, but my final account totalled $25000."* (p.15)

While the Law Commission's Women's Access to Justice project is only actively seeking contributions from women, many men have similar experiences[26].

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[24] There are sometimes other professions involved also, hence in the Family Court there may be input from counsellors, psychologists, accountants, and actuaries, for example.

[25] Women's Access to Justice (April 1997) *Women's Access to Legal Advice and Representation*, Law Commission Miscellaneous Paper 9.

[26] This does raise the question why the Law Commission is only asking for contributions from women. Given that men and women are often in conflict in the Family Court, for example, changes to reduce women's dissatisfaction may not always also advantage men and could disadvantage them. The Women's Access to Justice project therefore

### 3.3.2 The Nature of Production - Prisoners' Dilemma?

The production of the legal service generally requires more than just a trade between a legal professional and a client. There are generally at least two, and sometimes several participants purchasing the service. The purchase of the entire service (such as a dispute resolution in the Family Court) is a joint purchase with other parties. However the parties are in conflict with each other and so they may well be uncooperative. One game-theoretic example of this sort of scenario is known as the prisoners' dilemma.

To summarise by means of a simple example, we could assume that two parties in dispute each have the option of being aggressive (uncooperative) or non-aggressive (cooperative). Assume that the outcome of the dispute is the same when both parties act in the same way (aggressive or non-aggressive). The preferable strategy for both would therefore be the non-aggressive one as this gives resolution at lower cost. However, there are gains for one party to be aggressive if the other is not. Similarly, if the other party is aggressive, there are losses incurred by the non-aggressive party. There are therefore incentives to each party to be aggressive. So long as one of the parties cannot be trusted not to be aggressive, the end result would be that both are aggressive.

Unless otherwise constrained, legal professionals may well feel pressured to operate aggressively. By acting in this way, they are safeguarding their clients against possible aggressive behaviour from the other party. If a lawyer tries to reduce a client's costs by proposing a conciliatory strategy, this might give the impression that he/she is unwilling to fight, thus increasing the possible gains of an aggressive strategy by the other party. While it is better if all parties are reasonable, there is an incentive for one to be unreasonable.

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seems surprisingly unbalanced. That is moving into the area of lawmaking and the equity of laws, however.

At the same time, communication on these matters between the parties to the dispute is often undertaken indirectly though lawyers. This can lead to less understanding, less trust, and less control by the parties. Disputes can therefore escalate. The parties are acting on the advice of lawyers and rely on this advice being appropriate. Lawyers are paid according to the amount of work done, which might in some cases affect their choice of strategy, as discussed next.

### 3.3.3 Objectives of the Participants

What objectives might those working in the legal system have?

Economic theory is commonly based on the assumptions of profit-maximising firms and utility-maximising consumers. While much of the literature on public sector involvement assumes a broadly benevolent objective such as maximising social welfare, writers such as Niskanen[27] and Downs[28] have suggested that we should assume that individuals in the public sector are also self-interested. They develop theories exploring the implications of assumptions that bureaucrats are budget maximisers and politicians are vote maximisers. Posner touches on some of these ideas in relation to the legal sector[29].

It might be appropriate to assume that lawyers in private practice are income or profit maximisers. Cotter and Roper speculate on whether the legal profession should be considered a profession or a

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27 Niskanen W A (1971) *Bureaucracy and Representative Government*, Chicago: Aldine, and Niskanen W A (1973) *Bureaucracy: Servant or Master?* Hobart Paperback 5, London: Institute of Economic Affairs.

28 Downs A (1957) *An Economic Theory of Democracy*, New York: Harper and Row.

29 See section 22.5 of Posner R A ((1992) *Economic Analysis of Law*, 4th edition, Boston: Little, Brown and Co.. He is describing the behaviour of administrative agencies. He gives reasons for concluding that, *"the average agency is bound to be less well managed than the average business firm"* (page 610), but also gives other possible explanations besides inefficiencies which could justify their behaviour.

business[30]. They see the distinction as one between people bound by professional ethics and people allowed a free hand to make money. As even businesses can have specifications set down regulating the nature of their product, the distinction is perhaps more academic than real. Nevertheless, profit-maximising lawyers have to decide what strategy to advise their clients to follow.

Given imperfect information by clients, lawyers have some discretion in this. The issue of "supplier-induced demand" is discussed in literature on health economics[31]. The suggestion is that, as the supplier is also the person advising on what should be purchased, there is scope to advise more, or more expensive, actions[32]. Given the added complication with legal services that actions of other parties can also influence the services required, there may well be scope for lawyers to create work for each other while apparently acting to protect their clients.

Costs can also escalate beyond those anticipated by either the client or the lawyer, depending in part on strategies followed by other parties, events in court, et cetera (in other words, it may not be possible to accurately estimate costs at the beginning). They do face some constraints, however. Lawyers cannot consistently propose very expensive, unsuccessful strategies as this would result in their getting fewer clients, but low cost strategies may also not give satisfactory results.

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30 Section 10.2 of Cotter W B and Roper C (undated, 1996?) *Report on a project on Education and Training in Legal Ethics and Professional Responsibility for the Council of Legal Education and the New Zealand Law Society*.

31 See, for example, page 187 of Feldstein P J (1993) *Health Care Economics*, New York, Delmar, or pages 160-3 of McGuire A, Henderson J and Mooney G (1988) *The Economics of Health Care*, London: Routledge.

32 Section 8 of the Family Proceedings Act 1980 would, if enforced, serve as a partial constraint on "supplier-induced demand". That this provision has been made is itself an acknowledgement of a problem.

As for other paid participants in the legal system, there is scope for the development of theories based on various assumptions about their objectives. Perhaps someone could suggest what it is that self-interested judges might be trying to achieve.

### 3.3.4 The Nature of Costs

A common measure of the cost of a good or service is the price paid. This is not the only type of cost associated with legal action. Other costs include monetary costs such as pay foregone due to lawyers' visits and court appearances, and costs of time spent by clients gathering relevant information. These should be noted because reduced legal fees may be achieved by passing on parts of the work to clients. Fees charged will not then fully describe the resource costs incurred[33]. When evaluating a service, it can be important to know from what perspective the evaluation is being done. For example, costs and benefits to an individual may be different from costs and benefits to the public sector, or to society as a whole. An approach which might be efficient when evaluated from one perspective may not appear so desirable from another. We could also consider psychological and other costs arising from stress and uncertainty. These can be significant, and have achieved publicity in some recent criminal cases, but they are hard to measure.

There are also costs arising from the time required to achieve a resolution. That will be the focus of this section.

Posner (1992) discusses time in section 21.12: *" … court delay is a 'figurative' as distinct from a 'literal' queue. Waiting in line for a table at a restaurant is a literal queue; it imposes an opportunity cost measured by the value of the customer's time while waiting."*

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[33] There are parallels with the concepts of "administration" and "compliance" costs in taxation literature. See, for example, pages 302-3 of Musgrave RA and Musgrave P B (1982) *Public Finance in Theory and Practice*, 3rd edn., International Student Edition, London: McGraw-Hill.

(page 578) While this is correct, time delays may not be costless to the parties involved. For example, assets can be tied up, restricting options or requiring borrowing in the meantime. It can be harder to plan ahead, given the uncertainty. Delays may even affect the outcome, as with interim custody arrangements affecting final custody decisions[34]. These costs of time may not be evenly spread over parties in a dispute. As a result, delaying tactics may be advantageous to some parties and detrimental to others.

Posner states that, "*People queue up to buy litigation but not to buy lobsters because judicial time is not rationed by price and lobsters are.*" (page 579). Rather than price-based rationing, there is time-based rationing through queuing. He is justified in stating in general that reducing time delays will increase demand, but he bases his reasoning on the single purchaser model, whereas litigation involves more than one person. Only one of these needs to express a demand, and time delays may even be advantageous for that person. The magnitude of the deterrent effect of queues on demand is therefore not so easy to determine.

It should also be noted that people cannot currently pay for a judge's time. How much would they buy if they could? Would the supply be the same? If demand increases with fewer delays, would this result in a welfare improvement? Would people want legal services to be handled in the current way if there were other options? Currently the supply of judiciary services and the nature of the product provided by the courts are largely set by government, rather than being based on economic factors. There may be good reasons for government involvement, but an economist would suggest that economic aspects must still be considered to determine an appropriate level and form of provision. These aspects might include consideration of externalities (such as the effect of decisions on the actions of others), equity (given people's differing abilities to pay), judicial independence (so no payment from a party would influence

[34] See below.

outcomes), and state supervision (appointment of judges, etc.), for example[35].

Given that the government sets the supply of judicial services, the only conclusion we might be able to draw from the existence of queues is that supply is less than demand at zero price. If there are other factors to consider, as described above, we cannot determine whether supply is too low or too high.

Posner also states:

> *"The main response to the growth in demand has been to add judges and supporting judicial personnel. Such a response is unlikely to have a significant effect on court delay other than in the very short run. By increasing the quality of legal redress, at least to those who value prompt justice, an expansion in the number of judges will induce some people to use the courts who previously had been deterred by the delay."* (Posner, 1992, page 579)

The effect on court delay depends on the extent to which demand increases. It should also be noted that cases are not resolved in zero time, so there can be delays in processing because of time required for specialist reports or other preparation, waiting for availability of witnesses, counsel, or other parties, and so forth. Rather than a simple queuing problem, the issue is more one of complex scheduling. Queues are likely to exist under the best of circumstances.

As a specific Family Court example of the relevance of time as a factor determining outcomes, consider the following quote by New Zealand's Principal Family Court Judge, Patrick D. Mahony[36]:

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[35] Posner (1992) mentions both income distribution and externality factors on page 581.

> *"Young children need routine. Their sense of security is often built around familiarity of environment, familiarity and consistency of caregiving. Those are very important factors for young children. Their bonding is very closely tied to their sense of security."*

In practice, the Family Court puts great weight on the status quo when considering custody issues. Whichever parent was the "primary caregiver"[37] before separation, or has the children for most nights after separation (if the mother), is therefore greatly favoured on the basis that this would provide continuity for the children. The longer an interim arrangement lasts, the harder it is to achieve any change. Delays in resolving custody matters therefore favour the parent with effective custody[38].

This also limits options available if a party is not satisfied with an initial decision. While a decision can be appealed, appropriate remedies at that time may not be the same as appropriate decisions in the first instance.

### 3.3.5 Monitoring

One component of policy implementation is monitoring. If the laws are intended to achieve certain outcomes, the system put in place should include gathering appropriate data to see how well those outcomes are being met. Lawmakers have no way of knowing if laws are being applied as intended unless they monitor the courts. In the following two areas at least, this does not happen.

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36 *60 Minutes*, 5 January 1997.

37 Commonly considered to be the mother if she spent less time than the father in paid work.

38 An example of "possession being nine tenths of the law", although it is said that children are not property?

### 3.3.5.1 Custody

A 1980 amendment to the Guardianship Act 1968 introduced subsection 23.1.a, which includes the statement that, *"regardless of the age of a child, there shall be no presumption that the placing of a child in the custody of a particular person will, because of the sex of that person, best serve the welfare of that child"*. On the second reading of the Bill introducing the amendment, Hon J.K.McLay (Minister of Justice) said[39]:

> *"There are those who believe that fathers do not gain custody of their children more often because the judiciary discriminates in favour of mothers. If any lingering trace of the so-called mother principle does in fact survive, it will be eradicated by the proposed new subsection (1A) of section 23, inserted by clause 8 of the Bill."*

However, in 1990 the Department of Statistics ceased collecting information on the award of custody by gender of parent, and the then Department of Justice took no decision about collecting it[40].

### 3.3.5.2 Denial or Obstruction of Access

On the issue of denial or obstruction of access, in February 1996 Hon D A M Graham (Minister of Justice) stated[41]:

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39 *New Zealand Parliamentary Debates*, Vol.435 (Nov 6-Nov 27 1980), page 5432.

40 Hon D A M Graham (Minister of Justice), answer to question for written answer no. 204, lodged 20 February 1996, *New Zealand Parliamentary Debates: Question Supplement*, vol. 23, 20 February-4 April 1996, page 5103.

41 Hon D A M Graham (Minister of Justice), answer to question for written answer no. 203, lodged 20 February 1996, *New Zealand Parliamentary Debates: Question Supplement*, vol. 23, 20 February-4 April 1996, page 5103.

*Under the Guardianship Act 1968 it is an offence punishable by a maximum fine of $1000 to hinder or prevent access to a child by a person entitled to access. Custodial parents who deny or obstruct access may also be found in contempt of Court. There is no data available on how often penalties in relation to the denial or obstruction of access have been imposed in the last 5 years.*

### 3.3.6 Mediation as an Alternative Approach

New Zealand's Legal Services Board is attempting to promote mediation as an alternative method of dispute resolution[42], but is meeting some resistance from the legal profession. Objections appear to arise from a perception that mediation is a second-rate solution and a feeling that a client is lost when handed over to mediation. Nevertheless, the Legal Services Board is funding legal aid for some mediation services.

## 3.4 Efficiency of the Control Mechanisms to Ensure Participants Follow the Rules

Barristers and Solicitors are guided by the *Rules of Professional Conduct for Barristers and Solicitors*. There is a complaints process specified by the Law Practitioners Act 1982 whereby District Law Societies investigate complaints. If a complainant is not satisfied with the outcome of a complaint, the matter can be referred on to a Lay Observer.

### 3.4.1 Report of the Lay Observers

In the *Report of the Lay Observers for the year ended 30 June 1994* (presented to the House of Representatives), several Lay Observers noted that the District Law Societies are not able to do as much in relation to complaints as many complainants would wish. One Lay

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[42] Reported in the *Evening Standard*, 21 April 1997, page 4.

Observer stated that, *"The public perception of lawyers is not good and there is certainly a need for people's faith in lawyers to be restored"*. There appears to be a view that someone dissatisfied with an outcome could, and possibly should, generally pursue further legal avenues to remedy this. The general comment by another Lay Observer is telling:

> *"A major source of difficulty in dealing with complainants is the task of explaining the limitations under which Law Societies and Lay Observers operate. Many complainants have the expectation that the Lay Observer is able to direct a Law Society to take particular action in respect of their complaint and are disappointed to find that this in not the case. This applies particularly where the complainant is desirous of some punitive action being taken against the practitioner concerned.*
>
> *It appears that economic considerations often militate against civil legal action being undertaken, and complainants often expect that the Law Society will take on the role of the Courts."*

The last sentence suggests that the real expected procedure for most complaints is to go to Court. For those who already feel that they have grounds for complaint about their experience in the legal system, this may not appear a very satisfactory option.

### 3.4.2 Report by Cotter and Roper

More recently a report on legal ethics has been written by W Brent Cotter QC and Christopher Roper[43]. Section 2.6 of the report is

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[43] W Brent Cotter QC and Christopher Roper, *Report on a project on Education and Training in Legal Ethics and Professional Responsibility for the Council of Legal Education and the New Zealand Law Society*, undated, but released in 1997.

reproduced in Appendix 2. The report identifies numerous problems with the Rules including:

1. ignorance of them;
2. a conscious risk-taking to get around them;
3. perceived inconsistencies in the Rules;
4. the lack of rigour in enforcing them;
5. different application according to district;
6. application with different degrees of rigour over parts of the profession.

Section 10 of the report elaborates further on these matters, giving possible reasons why the current situation has arisen.

It would seem that the legal profession's attempts at self-regulation to date are not entirely successful. This is a concern, given Judge Mahony's reference to a "heavy professional onus" on members of the legal profession to act appropriately and present fair and balanced evidence[44].

### 3.4.3 Posner on Controls

Posner[45] states that:

> *"An important question about the social responsibility of corporations is whether the corporation should always obey the law or just do so when the expected punishment costs outweigh the expected benefits of violation…One resolution is for the corporation to proceed on the assumption that it*

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[44] Page 64 in Mahony P. 'The Domestic Violence Act 1995: "The End of a Process and a New Beginning"', pages 56-66 in Patrick J, Foster H and Taper T (eds) (1997) *Successful Practice in Domestic Violence in New Zealand*.

[45] Pages 421-2 of Posner R A (1992) *Economic Analysis of Law*, 4th edition, Boston: Little Brown

> *is not its business to correct the shortcomings of the politico-legal system; its business is to maximise profits…if instead it takes the ethical approach, this will have the perverse result of concentrating resources in the hands of the least ethical businessmen."*

Similar reasoning could be applied to professionals in the legal sector, raising further questions about behaviour in the context of the issues of principal-agent, prisoners' dilemma and supplier-induced demand discussed in sections 3.3.1 to 3.3.3 above.

## 4. CONCLUSIONS/SUGGESTIONS

Assessment, evaluation of service delivery, etc., are increasingly being applied in numerous areas of the public sector (eg health, education). How well would the legal system stand up to such scrutiny?

From an economics perspective, there are several areas where efficiency gains might be achievable. In many cases this simply involves awareness and consideration of the economic implications of the approaches taken. From the discussion in this paper, the following areas can be identified:

1. clearer laws - through the removal of identified ambiguities;
2. more appropriate laws - suitable for a wide range of situations, so there is less need for special arrangements to be made;
3. greater awareness of costs of all kinds;
4. more concern for time factors - acknowledging the costs and distortions which may arise;
5. assessment and monitoring;
6. complaints procedures, quality control.

## APPENDIX 1

Family Law Act, 1986, Ontario, Part 1 Sections 4 and 5
(from: http://www.interlog.com/~alchemy/fla.html)

PART I

FAMILY PROPERTY

4.-(1) In this Part,

"***court***" means a court as defined in subsection 1 (1), but does not include the Provincial Court (Family Division); ("tribunal")

"***matrimonial home***" means a matrimonial home under section 18 and includes property that is a matrimonial home under that section at the valuation date ("foyer conjugal")

"***net family property***" means the value of all the property, except property described in subsection (2), that a spouse owns on the valuation date, after deducting,

(a) the spouse's debts and other liabilities, and

(b) the value of property, other than a matrimonial home, that the spouse owned on the date of the marriage, after deducting the spouse's debts and other liabilities, calculated as of the date of the marriage; ("biens familiaux nets")

"***property***" means any interest, present or future, vested or contingent, in real or personal property and includes,

(a) property over which a spouse has, alone or, in conjunction with another person, a power of appointment exercisable in favour of himself or herself,

(b) property disposed of by a spouse but over which the spouse has, alone or in conjunction with another person, a power to revoke the disposition or a power to consume or dispose of the property, and

(c) in the case of a spouse's rights under a pension plan that have vested, the spouse's interest in the plan including contributions made by other persons; ("bien")

"***valuation date***" means the earliest of the following dates:

1. The date the spouses separate and there is no reasonable prospect that they will resume cohabitation.

2. The date a divorce is granted.

3. The date the marriage is declared a nullity .

4. The date one of the spouses commences an application based on subsection 5 (3) (improvident depletion) that is subsequently granted.

5. The date before the date on which one of the spouses dies leaving the other spouse surviving. ("date d'evaluation") 1986, c. 4, s. 4 (1); 1986, c. 35, s. 1 (1).

***(2) The value of the following property that a spouse owns on the valuation date does not form part of the spouse's net family property:***

1. Property, other than a matrimonial home, that was acquired by gift or inheritance from a third person after the date of the marriage.

2. Income from property referred to in paragraph 1, if the donor or testator has expressly stated that it is to be excluded from the spouse's net family property.

3. Damages or a right to damages for personal injuries, nervous shock, mental distress or loss of guidance, care and companionship, or the part of a settlement that represents those damages.

4. Proceeds or a right to proceeds of a policy of life insurance, as defined in the Insurance Act, that are payable on the death of the life insured.

5. Property, other than a matrimonial home, into which property referred to in paragraphs 1 to 4 can be traced.

6. Property that the spouses have agreed by a domestic contract is not to be included in the spouse's net family property. 1986, c. 4, s. 4 (2); 1986, c. 35,

*(3) The onus of proving a deduction under the definition of "net family property" or an exclusion under subsection (2) is on the person claiming it.*

*(4) When this section requires that a value be calculated as of a given date, it shall be calculated as of close of business on that date.*

*(5) If a spouse's net family property as calculated under subsections (1), (2) and (4) is less than zero, it shall be deemed to be equal to zero. 1986, c.4, s.4 (3-5)*

5. (1) When a divorce is granted or a marriage is declared a nullity, or when the spouses are separated and there is no reasonable prospect that they will resume cohabitation, the spouse whose net family property is the lesser of the two net family properties is entitled to one-half the difference between them.

   (2) When a spouse dies, if the net family property of the deceased spouse exceeds the net family property of the surviving

spouse, the surviving spouse is entitled to one-half the difference between them.

(3) When spouses are cohabiting, if there is a serious danger that one spouse may improvidently deplete his or her net family property, the other spouse may on an application under section 7 have the difference between the net family properties divided as if the spouses were separated and there were no reasonable prospect that they would resume cohabitation.

(4) After the court has made an order for division based on subsection (3), neither spouse may make a further application under section 7 in respect of their marriage.

(5) Subsection (4) applies even though the spouses continue to cohabit, unless a domestic contract between the spouses provides otherwise.

(6) The court may award a spouse an amount that is more or less than half the difference between the net family properties if the court is of the opinion that equalizing the net family properties would be unconscionable, having regard to,

(a) a spouse's failure to disclose to the other spouse debts or other liabilities existing at the date of the marriage;

(b) the fact that debts or other liabilities claimed in reduction of a spouse's net family property were incurred recklessly or in bad faith;

(c) the part of a spouse's net family property that consists of gifts made by the other spouse;

(d) a spouse's intentional or reckless depletion of his or her net family property;

(e) the fact that the amount a spouse would otherwise receive under subsection (1), (2) or (3) is disproportionately large in relation to a period of cohabitation that is less than five years;

(f) the fact that one spouse has incurred a disproportionately larger amount of debts or other liabilities than the other spouse for the support of the family;

(g) a written agreement between the spouses that is not a domestic contract; or

(h) any other circumstance relating to the acquisition, disposition, preservation, maintenance or improvement of property.

(7) The purpose of this section is to recognize that child care, household management and financial provision are the joint responsibilities of the spouses and that inherent in the marital relationship there is equal contribution, whether financial or otherwise, by the spouses to the assumption of these responsibilities, entitling each spouse to the equalization of the net family properties, subject only to the equitable considerations set out in subsection (6). 1986, c. 4, s. 5.

## APPENDIX 2

Section 2.6 of W Brent Cotter QC and Christopher Roper, *Report on a project on Education and Training in Legal Ethics and Professional Responsibility for the Council of Legal Education and the New Zealand Law Society*, undated, but released in 1997.

### 2.6 The need/the problem

We believe that our discussions at the meetings held reinforce the view of the Council and the Society that there is indeed a need for an educational program. Time and again we were told of ignorance of the *Rules of Professional Conduct for Barristers and Solicitors* (the Rules), or of a lack of realisation of how inviolate the Rules are. It seems the meaningfulness or significance of the Rules is not appreciated. We were told there was not so much a lack of knowledge of the Rules; rather a conscious risk-taking to get around them, because of commercial convenience, or potential loss of the client, or simply the desire to win.[9]

It was put to us that there is not so much a lack of knowledge of the Rules but rather there exists a different corpus of authority[10], which is frequently relied upon. It is a matter not so much of not knowing but not knowing if what was known had meaning or not. This "alternative authority" environment is reinforced by the perceived inconsistency in the Rules and the lack of rigour in enforcing them. We heard repeatedly that the Rules appeared to be applied differently in different districts in the country, and that they appeared to be applied with differing degrees of rigour to different parts of the profession. As well, when the Rules were discussed by panels of senior lawyers, the apparent imprecision in the rules often led senior and well-respected commentators to reach conflicting positions regarding the application of the rules to lawyers' conduct, reinforcing the impression that any course of conduct was acceptable, or at least not contrary to the Rules.

Our perception is that there is a lack of agreement on many legal ethics issues in the New Zealand legal profession as a result of:

- the lack of clear and generally accepted principles of professional responsibility and ethical conduct; and
- its absence, generally, from the curriculum of the law schools or the IPLS.

The absence of attention to legal ethics sends a latent message that they are not important or relevant. We believe that a coordinated curriculum will send a message to the profession and to students that legal ethics is central to what law and being a lawyer is about.

We make a recommendation in relation to the Rules (see section 9.1 of this report).

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9. This suggests it is both an education and regulation problem.

10. The "different corpus of authority" might come from the president of the local district law society, the senior partner of the firm or its ethics committee.

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**CENTRE FOR PUBLIC POLICY EVALUATION**
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