

**BACKGROUND PAPER**

# ***Lawyers Behaving Badly?***

## ***Legal Costs and Letters of Demand***

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***“The lawyer who gives the chief place in his thought to the question of making money will eventually come to the place in his experience where everything else will be completely subordinated to that, while he who feels that he would rather be the instrument of justice than, be the perversion of the right way, to receive himself a large reward, and who loves truth and honour more than money will reap a better reward in the approbation of his own conscience and will lay up in store for the time to come something more enduring than anything that money can buy”<sup>1</sup>***

### **Methodology**

This discussion paper is largely based upon interviews conducted by the author with a small number of experts in the field. This primary research has also been supplemented by a literature review.

All interviewees were provided with an identical questionnaire. The interviewees form only a small sample of experts in the field; however, their responses provide a useful insight into the issue.

### **Introduction**

The practice of lawyers claiming costs in letters of demand has been identified as a problem by community lawyers and the consumer movement since the late 1970s.<sup>2</sup> The objection to the practice is based on the fact that legal costs against another party are not enforceable prior to the issue of legal proceedings.<sup>3</sup>

Within the legal profession, there has been considerable polarisation on the issue in the past.<sup>4</sup> Until recently, the Law Institute of Victoria’s ethical guidelines on letters of demand stated, “... costs to date are properly claimable in a letter of demand. However, care must be taken to avoid an implication that costs are enforceable if proceedings have not been issued.”<sup>5</sup>

In November 2007, the Law Institute of Victoria chose to update its “letters of demand guidelines”.<sup>6</sup> The new guidelines explain that the Ethics Committee reconsidered their position after the decision in *Collection House v Taylor* [2004] VSC 49 “where certain conduct of debt collectors was found to be unconscionable.”<sup>7</sup> The change can also be attributed a sustained

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<sup>1</sup> Hammond, “The Mission of the Lawyer” (1904), reprinted in (1990) 41 Mercer L Rev 589 at 593

<sup>2</sup> Interview with Gary Sullivan, Solicitor West Heidelberg Community Legal Service, (West Heidelberg Community Legal Service, 15 May 2008)

<sup>3</sup> Ibid

<sup>4</sup> Ibid

<sup>5</sup> “Providing Precedent Letters of Demand”, *Law Institute Journal* (1999) 73 No 10 October, 92-3

<sup>6</sup> Law Institute of Victoria, “Letters of Demand Guidelines” available at: [http://www.liv.asn.au/regulation/ethics/pdf/guide\\_lettersdemand.pdf](http://www.liv.asn.au/regulation/ethics/pdf/guide_lettersdemand.pdf)

<sup>7</sup> Law Institute of Victoria, “Letters of Demand Guidelines” available at: [http://www.liv.asn.au/regulation/ethics/pdf/guide\\_lettersdemand.pdf](http://www.liv.asn.au/regulation/ethics/pdf/guide_lettersdemand.pdf)

campaign by community legal centres and the consumer movement.<sup>8</sup> The new examples of precedent letters provided by the Ethics Committee do not include a claim for legal costs to date.<sup>9</sup>

This report will focus primarily on letters of demand sent to debtors, which wrongly claim for costs. There are two key concerns regarding this practice:

1. It may constitute misleading and deceptive conduct, as well as unconscionable conduct; and
2. It is not consistent with the high ethical standards expected of the legal profession and may breach professional standards of conduct.

This report will examine the legal and ethical concerns relating to the practice of lawyers claiming costs in letters of demand. It will also consider the current extent of the problem and make recommendations for educating the profession and eliminating the practice.

### **The Current Extent of the Problem:**

The update of the Ethic Committee's Guidelines has not stopped the practice of lawyers wrongfully claiming costs in letters of demand.<sup>10</sup> Clients of the Banyule Community Health Service's Financial Counselling Service have received letters of demand requesting the payment of legal costs since the release of the new guidelines in November 2007.<sup>11</sup> The Consumer Action Law Centre also reports that they have seen letters breaching the new Ethics Committee Guidelines.<sup>12</sup>

The practice has been linked to the increasing outsourcing of debts and the increasing nationalisation of debt collection agencies.<sup>13</sup> According to CEO of the Law Institute CEO of the Law Institute of Victoria, Michael Brett Young stated that: "Very few legal firms write letters of demand... The group that write most of the letters of demand are debt collection companies that have solicitors attached to them."<sup>14</sup>

It is increasingly common for debt collection agencies and law firms to work closely together.<sup>15</sup> As discussed in a recent report, these business relationships "have the potential of blurring the

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<sup>8</sup> Interview with Gary Sullivan, Solicitor West Heidelberg Community Legal Service, (West Heidelberg Community Legal Service, 15 May 2008)

<sup>9</sup> Ibid

<sup>10</sup> Interview with Phil Lennon, Financial Counsellor, (Banyule Community Health Service, 8 May 2008)

<sup>11</sup> Appendix 1

<sup>12</sup> Email from Paul Gillet (Consumer Action Law Centre) to Kara Sheehan, 29 May 2008

<sup>13</sup> "Selling their Customers Out: Consumer Problems with Debt Collection Outsourcing in Australia", Consumer Credit Legal Service Inc (2002)

<sup>14</sup> Interview with Michael Brett Young, CEO Law Institute Victoria, (Telephone Interview, 14 May 2008).

<sup>15</sup> Interview with Phil Lennon, Financial Counsellor, (Banyule Community Health Service, 8 May 2008)

boundaries between the solicitor and debt collection agency...causing some of the problems that legal practice rules were intended to prevent.”<sup>16</sup> Other legal practice issues related to this are: failing to provide adequate legal supervision of staff, lack of knowledge of relevant laws, and failure to provide documents.<sup>17</sup>

It is difficult to determine exactly how widespread the practice of letters of demand wrongfully claiming for legal costs are. The Legal Services Commissioner’s Annual Report reveals that there were 99 complaints regarding Debt Collection in Victoria for 2007.<sup>18</sup> However, these complaints may have been related to a wide range of issues concerning debt collection. The author conducted an interview with a spokesperson from the Legal Services Commission, however, they were unable to comment on the nature of complaints received due to confidentiality requirements<sup>19</sup>.

Gary Sullivan, from the West Heidelberg Community Legal Service, explains that prior to the changes to the ethical guidelines, these matters were dealt with on a case-by-case basis. Before the changes to the ethical guidelines it was unlikely that that formal complaints would be made. Now, however, community legal services may increasingly register complaints against lawyers who engage in these practices against the new ethical guidelines.<sup>20</sup>

### **Legal Concerns:**

There is a strong argument that demanding the payment of legal costs on letters of demand prior to the issue of legal proceedings may constitute both misleading and deceptive conduct, and unconscionable conduct.

### **Misleading and Deceptive Conduct:**

Both the *Fair Trading Act 1999* (Vic) and the *Trade Practices Act 1974* (Cth) prohibit “conduct that is misleading or deceptive or is likely to mislead or deceive”.<sup>21</sup> The average consumer who receives a letter of demand from a law firm would be likely to conclude that there is a legal basis for the demands set out in that letter. This is because, theoretically at least, lawyers are presumed to know the law.<sup>22</sup>

The decision in *Collection House v Taylor* [2004] VSC 49 gives weight to the view that this practice constitutes misleading and deceptive conduct under both the *Fair Trading Act 1999* (Vic)

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<sup>16</sup> “Selling their Customers Out: Consumer Problems with Debt Collection Outsourcing in Australia”, Consumer Credit Legal Service Inc (2002), 10

<sup>17</sup> Ibid, 24

<sup>18</sup> Legal Services Commission, *Legal Services Commissioner 2007 Annual Report*, 22, available at [http://www.lsc.vic.gov.au/pdf/LSC\\_Annual\\_Report\\_2007.pdf](http://www.lsc.vic.gov.au/pdf/LSC_Annual_Report_2007.pdf)

<sup>19</sup> Interview, Legal Services Commission.

<sup>20</sup> Interview with Gary Sullivan, Solicitor West Heidelberg Community Legal Service, (West Heidelberg Community Legal Service, 15 May 2008)

<sup>21</sup> *Fair Trading Act 1999* (Vic), s9; *Trade Practices Act 1974* (Cth), s52

<sup>22</sup> Interview with Liz Curran, solicitor, West Heidelberg Community Legal Service, (15 May 2008)

and the *Trade Practices Act 1974* (Cth).<sup>23</sup> In this case it was held that failing to explain that a debt is not legally enforceable may amount to misleading and deceptive conduct.<sup>24</sup>

Many letters of demand, which request the payment of legal costs along with payment of the original debt, do not seek to explain that the costs are not legally enforceable.<sup>25</sup> In fact demanding the payment of legal costs on a letter from a qualified solicitor, implicitly suggests that the costs *are* legally enforceable. This assertion of a legal right to enforce costs is strengthened when the letter also threatens to initiate legal proceedings if the debt, together with costs, is not paid.<sup>26</sup>

#### Unconscionable Conduct:

The case of *Taylor v Collection House Limited* (2000 VSC 49) also provides an authority for the view that unconscionable conduct may be found where someone has collected money from another party on the basis of their lack of knowledge of their right to refuse payment.<sup>27</sup> The majority of professionals interviewed for this project reported that they did not believe consumers would be generally aware that these costs were not legally enforceable.

#### **Ethical Concerns:**

##### Why may the practice be unethical?

There is concern that the demand for payment of legal costs prior to the issue of legal proceedings conforms to the high ethical standards required of the legal profession. Some of the ethical problems associated with the practice are that:

1. The practice assumes the debt is owed and that there is an entitlement to the costs at law
2. The practice takes advantaged of the authority of lawyers, their position in society, and the ignorance of consumers.
3. The costs sought may bear no relation at all to the actual cost of the legal work that has been done.

##### Assumption that debt is owed:

When a claim is made for legal costs in a letter of demand, there is a clear assumption that the recipient of the letter is in the wrong, and does owe the debt in question.<sup>28</sup> Prior to the issue of proceedings, this assumption remains unsubstantiated.

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<sup>23</sup> Letter from Paul Gillet, Gary Sullivan and Dennis Nelthorpe to Michael Brett Young, 28 June 2007 (Consumer Action Law Centre).

<sup>24</sup> *Collection House v Taylor* [2004] VSC 49

<sup>25</sup> Interview with Denis Nelthorpe, Solicitor and consumer lawyer (13 May 2008)

<sup>26</sup> *Collection House v Taylor* [2004] VSC 49

<sup>27</sup> *Ibid*

<sup>28</sup> Interview with Denis Nelthorpe, Solicitor and consumer lawyer (13 May 2008)

The trend of outsourcing debt has further complicated this issue. As pointed out by Dennis Nelthorpe, in a time where debts are brought and sold, it is increasingly difficult to establish whether the debt is owed.<sup>29</sup> This is because, in some cases, the law firms and debt collection agencies do not appear to be in possession of all the documents relating to the debt.<sup>30</sup>

The practice of claiming legal costs becomes highly questionable in situations where the recipient of the letter of demand does not actually owe the debt in the first place.<sup>31</sup> A number of experts in the field interviewed for this project reported that they have seen cases where the recipient of a letter of demand has paid the debt, together with legal costs, despite not owing the debt in the first place.<sup>32</sup> This is attributed to the following factors: a limited grasp of English, a limited understanding of our legal system or society, and a fear of authority and the legal system.<sup>33</sup>

#### **Case Study 1**

*Client A, who was from a non-English speaking background, received a letter from Law Firm X pursuing a debt on behalf of a collection agency. Client A had allegedly taken money from the payroll of a government department. Client A did not owe this debt and this was clearly indicated in the file notes of the relevant department. However, the debt had been sold, minus the file notes, to a debt collection agency.*

*The debt being chased with the letter of demand related to this payroll money plus the cost of producing the letter of demand. Upon receiving the letter Client A, scared of the possibility of being taken to court, paid the debt together with legal costs. The client, unaware of his rights, only sought legal advice following a referral from a financial counsellor.<sup>1</sup>*

#### The practice may take unfair advantage of the professional standing of lawyers in the community

It can also be argued that these letters take advantage of the position of lawyers in society and therefore exploit consumers who have a limited understanding of the law. Upon receiving a letter of demand from a law firm, it would be normal for consumers to feel quite intimidated.<sup>34</sup> This may result in consumers paying the debt, along with the legal costs, due to fear of legal action.<sup>35</sup>

The payment of these legal costs has created ongoing financial problems for some clients of Financial Counsellor Phil Lennon. Mr Lennon reports that he seen clients in financial difficulty who received these letters of demand have been intimidated, and have over committed themselves financially by paying the debt, together with costs, which they were not legally obliged to pay at that point in time.<sup>36</sup> This creates additional stress for clients who are in a vulnerable position to begin with.<sup>37</sup>

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<sup>29</sup> Ibid

<sup>30</sup> Interview with Liz Curran, Solicitor, West Heidelberg Community Legal Service, (15 May 2008)

<sup>31</sup> Interview with Denis Nelthorpe, Solicitor and consumer lawyer (13 May 2008)

<sup>32</sup> Interview with Liz Curran, solicitor, West Heidelberg Community Legal Service (15 May 2008)

<sup>33</sup> Ibid; and Interview with Denis Nelthorpe, Solicitor and consumer lawyer (13 May 2008)

<sup>34</sup> Interview with Liz Curran, solicitor, West Heidelberg Community Legal Service (15 May 2008)

<sup>35</sup> Ibid

<sup>36</sup> Interview with Phil Lennon, Financial Counsellor, (Banyule Community Health Service, 8 May 2008)

<sup>37</sup> Ibid

The costs charged may not be appropriate

A number of the experts interviewed also raised questions regarding how the costs claimed in letters of demand are calculated. In some cases, there does not appear to be any relationship between the amount claimed and the actual cost of the legal work required to produce a letter of demand.<sup>38</sup>

**Case Study 2:**

*Client B received a letter of demand from Law Firm X claiming unpaid monies for a medical procedure. The letter of demand claimed \$270 in unpaid monies plus \$88 in legal costs, along with a request that this money be paid directly to the collection agency.*

*Client B paid the money directly to the original debtor and contacted the law firm (which shared a telephone number with the collection agency) by telephone. Client B was told they would have to pay legal costs as well. When asked for an explanation of the costs, the staff member on the end of the phone said "its just a charge we add to the debt, and the amount we charge will depend on how big the debt is".<sup>1</sup>*

Can the practice be justified?

While there are ethical concerns with claiming legal costs in letters of demand, some argue that these concerns need to be balanced with the needs of the client to whom the outstanding debt is owed.<sup>39</sup>

Assuming that the debt is owed, legal proceedings *may* be issued against the recipient of the letter of demand and this happens, costs can then be recoverable.<sup>40</sup> Michael Brett Young, CEO of the Law Institute of Victoria argues that:

“...the next step after a letter of demand is to start legal proceedings, and they can become very expensive. So yes there are some issues about letters of demand with a demand for payment of legal costs attached, but once legal proceedings begin it can get expensive very quickly.”<sup>41</sup>

While it is certainly true that clients must be able to pursue debts that are owed to them, care needs to be taken to ensure that practitioners act within the current ethical guidelines.

Another tension is that for some lawyers, asking for costs is seen as part of doing business, and “in business you do the bidding of clients.”<sup>42</sup> According to Gary Sullivan, there is a real danger

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<sup>38</sup> Interview with Denis Nelthorpe, Solicitor and consumer lawyer (13 May 2008)

<sup>39</sup> Interview with Michael Brett Young, CEO Law Institute Victoria, (Telephone Interview, 14 May 2008)

<sup>40</sup> Interview with Gary Sullivan, Solicitor West Heidelberg Community Legal Service, (West Heidelberg Community Legal Service, 15 May 2008)

<sup>41</sup> Ibid

<sup>42</sup> Interview with Denis Nelthorpe, Solicitor and consumer lawyer , (13 May 2008)

that lawyers may begin to think of themselves as business people before they are lawyers.<sup>43</sup> He argues that “the concept of service is fundamental to the profession” and that focusing upon the legal profession as a business, is an error which may result in the profession “losing its professional status in the eyes of the public.”<sup>44</sup>

### **Implications for the legal profession**

While only a small number of experts in the field have been interviewed for this report, all of the interviewees stated that the practice may have some impact upon the perception of the legal profession. This is cause for concern. The Law Institute of Victoria's *Professional Conduct and Practice Rules (2005)* state that:

“A practitioner must not, in the course of engaging in legal practice, engage in, or assist, conduct which is:

...

(iii) likely to diminish public confidence in the legal profession or in the administration of justice or otherwise bring the legal profession into disrepute.”<sup>45</sup>

From the questionnaire responses, it seems clear that the practice does threaten to diminish public confidence in the legal profession. One respondent stated “Lawyers don't look good when they do that sort of thing.”<sup>46</sup> Liz Curran, from the West Heidelberg Legal Service pointed out that it is quite an irony that whilst the legal profession has a bad reputation in the public arena, when consumers receive letters from lawyers they take their claims seriously.<sup>47</sup>

Another matter, which may be of greater concern, is that a number of the interviewees reported that they did not believe most legal practitioners were *aware* that legal costs were not enforceable prior to the issue of legal proceedings.<sup>48</sup> Clearly there is a need for the legal practice to be better informed.

It was also reported by some of the experts in the field that confusion about what is acceptable, had contributed to the prevalence of the practice. Paul Gillet, from the Consumer Action Law Centre, reports that -“...if there has been any confusion, it has arisen primarily because of the Ethics Committee's/LIV's original guidance.”<sup>49</sup> From

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<sup>43</sup> Interview with Gary Sullivan, Solicitor West Heidelberg Community Legal Service, (West Heidelberg Community Legal Service, 15 May 2008)

<sup>44</sup> Ibid

<sup>45</sup> Law Institute of Victoria, *Professional Conduct and Practice Rules (2005)*, section B (iii)

<sup>46</sup> Interview with Gary Sullivan, Solicitor West Heidelberg Community Legal Service, (West Heidelberg Community Legal Service, 15 May 2008)

<sup>47</sup> Interview with Liz Curran, solicitor, West Heidelberg Community Legal Service (15 May 2008)

<sup>48</sup> Interview with Liz Curran; Gary Sullivan; and Dennis Nelthorpe

<sup>49</sup> Email from Paul Gillet, Consumer Action Law Centre, to Kara Sheehan, 29 May 2008

these responses, it seems clear that there is need to ensure that the legal profession is aware of the updates to the Ethics Committee's updated guidelines on letters of demand.

However, as pointed out by Michael Brett Young, CEO of the Law Institute of Victoria, "ethics is not just about the latest ethics committee ruling. It's also about getting lawyers to understand and think about whether what they are doing has an ethical basis to it."<sup>50</sup> This issue is also about the culture of the legal profession and the need for a greater emphasis upon ethical practice by the profession.

### **Recommendations**

- That the new Guidelines on letters of demand be published in the Law Institute Journal in a timely fashion.
- That relevant law firms, and debt collection agencies, be contacted and informed of the updates to the Ethics Committee Guidelines.
- That the Law Institute of Victoria, publish advertisements in local community newspapers advising both consumers and practitioners of the changes to the Ethics Committee guidelines.
- That community legal centres, and other organisations, report breaches of the Ethics Committee's new guidelines to Legal Services Commissioner and other relevant bodies such as the ACCC.

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<sup>50</sup> Interview with Michael Brett Young, CEO Law Institute Victoria, (Telephone Interview, 14 May 2008)

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