



The Power of Market Competition: Enforcing High Ethical Standards in the Peruvian Legal System

I. Background: The need for improved legal ethics in Peru

Peru is the recent darling of Latin American economic development. Sustaining the far-reaching market reforms of the 1990's, Peru's GDP has grown on average 6.8% over the past seven years, faster than any other country in Latin America. Just as importantly, Peru is expected to weather the global economic downturn better than most of its peers. In August 2009, the Peruvian Minister of Finance projected that GDP will still grow in 2009, at a rate of 2.2%, with growth rates returning to above 5% in 2010 and beyond. Peru has also held its inflation rate at 2.4% over the past seven years, again, the lowest in Latin America. According to the Global Competitiveness Report of 2008-2009 published by the World Economic Forum, through competent fiscal and monetary policies, reasonably strong and sizable trade markets, a fairly developed financial market, and a strong investment grade status for its foreign investment, Peru has created a positive macroeconomic environment for business.

However, Peru's future success is tenuous. Peru has both weak institutions and low rule of law enforcement. In the World Bank's Worldwide Governance Indicators Rule of Law measure, Peru scored 25.8 out of 100, well below the Latin American average of 51.4 and the United States' score of 91.9.¹ Furthermore, corruption is rampant. Transparency International's 2008 Corruption Perceptions Index, a ranking of perceptions concerning corruption of a country's public officials, ranks Peru 72nd out of 180 countries.

Weak institutions, low rule of law enforcement and high corruption have numerous negative effects, not least of all on private sector development. The Global Competitiveness Report by the World Economic Forum puts Peru at a competitive disadvantage in such pillars of democracy and competitiveness as property rights, wasteful government spending, ethical behavior of firms, protection of minority shareholder's interest, strength of auditing and reporting procedures, time required to start a business, and all issues related to labor market efficiency.

Within this context of poor rule of law enforcement and weak institutions, the judicial system in particular is functioning poorly. Peruvians have an incredibly low opinion of their justice system. Only 15% of Peruvians feel that all citizens have equality before the law,² and when

¹ Worldwide Governance Indicators, 2008, <http://info.worldbank.org/governance/wgi/> (Date accessed: August 10, 2009).

² Latinobarómetro Annual Report 2008, pg. 98, <http://www.latinobarometro.org> (Date accessed: August 20, 2009).



asked about their confidence in the justice system, 93.6% of Peruvians report having either “not very much” or “none at all”.³

Corruption in the legal system is especially problematic, driven by a general lack of respect for the rule of law by both members of the legal profession and ordinary citizens. The World Bank’s Worldwide Governance Indicators for 2008 rank Peru in the bottom half of all countries for its ability to control corruption. The World Economic Forum’s Global Competitiveness Index for 2008-2009 puts Peruvian confidence in the efficiency of its legal framework as the 19th worst out of all countries surveyed, while faith in judicial independence is 20th worst. According to Latinobarómetro 2008, about half of all Peruvians feel that there is a “high” or “very high” probability of being able to bribe a judge.

In a 2008 survey of top corporate lawyers⁴, 74% of lawyers surveyed felt that out of every 10 lawyers, only 4 or less complied with high ethical standards. That same survey showed that while Peruvian lawyers feel it is important to have spaces for debate of ethics and high commitment of lawyers to ethics, the average lawyer gives very little importance to ethics in his or her daily practice.

The absence of ethics in a lawyer’s daily practice is partly due to the structural features of the legal profession in Peru. Unlike in most developed country contexts, lawyers in Peru are not officers of the court and lawyer ethics are poorly enforced. Bar associations function more like lawyers’ unions and work for the interest of lawyers not for the interest of citizens. There is almost no inclusion of ethics in lawyers’ training, and the standard for censure, and thus civil compensation, is ‘gross neglect’, meaning there are no repercussions for lawyers who violate norms of practice in “less” negligent ways.

Consequently, legal ethics in Peru has largely been enforced externally. The traditional approach to rule of law enforcement and reform has concentrated on robust laws and a “supply-side” approach. Efforts at reform in Peru have centered upon strengthening judicial statutory powers, increasing budgets, reducing government discretionary powers or trainings public officials. This has so far proved unsuccessful.

What exists in Peru is a market failure for ethical behavior and rule of law compliance. The supply-driven rule of law reform approaches, limited public role of lawyer ethics, and absence of institutional incentives for behavioral controls such as disbarment or malpractice have failed.

³ 2006 World Values Survey, [www. http://www.worldvaluessurvey.org/](http://www.worldvaluessurvey.org/) (Accessed August 21, 2009).

⁴ Survey of participants at the June 9th, 2008 Ethics & Pro Bono International Conference, CAD Ciudadanos al Día.



The market has failed because there is no demand for systematic rule of law enforcement amongst the actors with a stake in implementing the rule of law.

The results of this lack of legal ethical behavior are multiple. The high corruption and lack of rule of law enforcement, which are negative impacts on their own, also limit private sector development. The legal profession should act as both a bedrock of rule of law compliance as well as a key pillar of democracy, though currently in Peru it is accomplishing neither. Citizens suffer from not having full access to the justice system and from not being able to effectively seek redress when their individual rights are violated, and consequently have low trust in the legal profession and their government overall. Combined, these impacts undermine the continued consolidation of Peruvian democracy.

II. The Solution: Building an Ethical Legal Profession through Market Enforcement

The solution, then, lies in intervening to create a market for complying with legal ethics and the rule of law. CAD's innovative intervention does just that, by targeting lawyers and the private companies that hire them, and using competition amongst firms for corporate clients to drive compliance with high ethical standards.

Key to the intervention are private corporations operating in Peru. Many corporations in Peru do have strong internal codes of conduct and company values and principles that conform closely to the rule of law, while also relying on honorable and vigilant lawyers to monitor their behavior. However, ethical company conduct does not itself guarantee a strong institutional framework or compliance with the rule of law. In addition to upholding their own anticorruption and good governance policies, businesses have an additional role to play due to their market power in the legal industry. Private companies contract with law firms to meet their ongoing needs for legal services. Law firms thus compete amongst each other to remain attractive to private companies. Private companies, then, have the power to demand that the law firms with which they contract follow high ethical standards. This CAD initiative creates a mechanism for private sector firms to make such demands, while at the same time promoting legal sector adherence to the rules of professional conduct and establishing an independent body to arbitrate disputes and help manage the system.

The initial foundation for this project has already been laid. For the past five years, Beatriz Boza, Executive Director of CAD Ciudadanos al Día and Professor of Legal Ethics and Chair of Lawyer Ethics Courses at the Catholic University Law School, has led a team to revise and redraft the 1997 *Código de Ética y Responsabilidad Profesional del Abogado* (Code of Ethics and Professional Responsibility for Lawyers). A wide variety of legal-sector allies have played a part, including law students and deans of major Peruvian law schools, prominent and well-respected partners of Lima-based law firms, in-house counsels and directors from over thirty of



the largest banks and businesses in Peru, including Telefónica del Perú, Banco de Crédito del Perú, BBVA Banco Continental, Interbank Group, and Backus and Johnston Brewery, and public servants from national and international legal organizations. After five years of meetings, inputs, negotiations and revisions, these parties have agreed upon a proposed revised legal ethics code, the *Propuesta de Normas de Conducta y Responsabilidad del Profesional en Derecho* (Proposed Rules of Lawyer Conduct and Professional Responsibility). The Proposed Rules update or add new sections to the existing rules in order to confront the modern, global complexities of the practice of law today, including new rules and regulations about conflicts of interest, explicit norms about tackling corruption and withdrawing when confronted with client fraud, and duties of confidentiality. In a pioneering change, the Proposed Rules were created by the clients of legal services, including in-house counsels from different sectors and different types of institutions, from the largest banks and multinational corporations to smaller regional companies, and better reflect their need for ethical behavior and rule of law compliance.

One key component of the mechanism for creating a market for ethical behavior is the Rule of Law Pledge. The objective of the Pledge is to strengthen the capacity of corporations and the lawyers they work with to demand, monitor and promote compliance with high professional responsibility standards of the lawyers they retain, both in house and externally. It aims to alter the incentives of targeted actors of a profession such that change becomes in their best interest and a self-regulating system is established through the use of information, competition, and private enforcement. By signing the Rule of Law Pledge, private companies affirm that they will only contract lawyers and law firms who subscribe to the new Proposed Rules. The Pledge, already signed by over 20 corporations and law firms, is a tool, designed specifically for use in the private sector, that relies on the power of the market to enable those firms and companies who are committed to upholding the rule of law and ethical behavior in their own corporate practices to demand that other lawyers, firms and companies also do so.

Also key to the establishment of the system is the creation of an external body, led by Ciudadanos al Día (CAD), that will regulate enforcement of the Pledge and compliance with the Proposed Rules. This self-regulating, independent body's role will be to resolve conflicts, judge accusations of non-ethical conduct, and decide entry and exit of the system.

Overall, the initiative relies upon market forces to demand general Peruvian lawyer compliance with these updated, more complete ethical standards. Harnessing law firm and lawyer business competition, the Initiative relies upon market forces to create legal system change. Corporate governance will improve as accountability and transparency becomes more apparent. As citizens begin to see the business sector and the legal sector as trustworthy, this will lead to a better, fuller, and more vibrant democracy with improved labor and social relationships, a more attractive investment climate, reduced corruption, and improved access to justice.



III. About CAD

Since its founding in 2002, *Ciudadanos al Día* (CAD) has sought to revolutionize the relationship between citizens and their government in Peru. CAD, a Peruvian non-profit organization, works to improve the citizen-state relationship at all levels of government office by introducing interventions that lead to a state that is more transparent, efficient and equitable, and to a citizenry that is more informed, demanding and engaged.

Peru suffers from weaknesses in enforcing legal ethics, high levels of corruption, and low levels of citizen trust in lawyers and the legal profession. CAD's innovative, new Code of Ethics project addresses these challenges through a series of innovative interventions that change the incentives lawyers face to act ethically and capitalize on the market power of national and international firms to join the fight against corruption and unethical legal practice. CAD also leads a Pro Bono Clearinghouse that enforces lawyers' and law firms' commitment to providing Pro Bono services and creates a platform to unite the supply of Pro Bono services by these providers with the high demand from the Peruvian population.

Overall, CAD specializes in the use of competition to generate positive social outcomes like better governance, improved compliance with the rule of law, and reduced corruption. Its innovative programming and methodology create incentives for social change. By comparing government entities in cross-cutting categories like citizen service, social inclusion, and transparency, CAD intervenes to make government entities compete to best serve citizens. In RankinCAD, CAD surveys citizens' satisfaction with services at a range of governmental entities and then publishes the results, comparing the best and worst performers. Through their annual Best Practices in Public Management Prize, CAD celebrates government success, thereby documenting best practices, incentivizing public officials to improve and giving citizens concrete ideas for reforms that they themselves can demand.

For CAD, information is a tool that can be leveraged to simulate competition, generate citizen demand and give public officials incentives to improve. CAD generates high quality, credible research about government performance and then translates its findings into citizen-accessible language and recommendations. They support the media to embrace its role as a government watchdog and agent of social change, and feed their messaging – from their research, to competition to best practices - through journalists to citizens to stimulate their desire for change.

CAD's innovation is having an impact and gaining national and international recognition. In a 2007 survey of Peruvian policy makers, CAD ranked among the top six most influential NGOs in Peru. CAD is implementing its innovative project model with funding from such diverse development organizations as L'Agence Canadienne de Développement International (ACDI),



World Justice Project of the American Bar Association, Tinker Foundation, Open Society Institute, the Ford Foundation, and the National Endowment for Democracy.