

**FOIL**

FORUM OF INSURANCE LAWYERS

*the voice of the wider public interest*

A Response by the Forum of Insurance  
Lawyers to the Legal Services Board  
consultation on Referral Fees, referral  
arrangements and fee sharing.

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**FOIL** (The Forum of Insurance Lawyers) exists to provide a forum for communication and the exchange of information between lawyers acting predominantly or exclusively for insurance clients (except legal expenses insurers) within firms of solicitors, as barristers, or as in-house lawyers for insurers or self-insurers. FOIL is an active lobbying organisation on matters concerning insurance litigation.

**FOIL** has over 3000 members. It is the only organisation which represents solicitors who act for defendants in civil proceedings.

This response has been drafted following consultation with the membership.

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# **A Response by the Forum of Insurance Lawyers to the Legal Services Board consultation on Referral Fees, referral arrangements and fee sharing.**

## **Introduction**

FOIL members have followed keenly the debate on referral fees over recent years, and have read with interest the reports published by the Legal Services Consumer Panel and the report in question, by the Legal Services Board: 'Referral fees, referral arrangements and fee sharing'. In acting for defendants FOIL members are at the sharp end of the issues arising around referral fees, being involved in the negotiation and settlement of costs. In the context of the current consultation FOIL members are only concerned with referral fees in personal injury cases and no comments included in this response are directed at the arrangements for conveyancing or criminal advocacy.

The report of Lord Justice Jackson on civil litigation funding analysed many aspects of costs and funding and one of the most thought provoking facts which it emphasised was the finding that within the personal injury market defendants are responsible for payment of all of the costs involved: the costs of the cases which are won, the costs of the cases which are lost and the costs of the cases which are abandoned. The whole of the costs burden falls upon defendants, which in practice largely means insurers or large self-insureds. Over recent years the claimant lobby has been keen to promote the argument of 'polluter pays' – the proposition that, as defendants who pay costs are by definition 'guilty parties', the focus should be entirely on the perceived requirements of claimants without reference to the impact of costs on the defendant. Lord Justice Jackson's finding highlights the fallacy of that argument, and emphasises the reality of the situation, that costs are indeed an access to justice issue and that the high levels of legal costs are impacting unfairly upon defendants and affecting their access to justice.

This is an argument that is being recognised increasingly by experienced commentators and judges. Lord Justice Jackson himself emphasised that for access to justice to be a reality it requires costs to be proportionate. As he says in his report:

*"Access to justice is only practicable if the costs of litigation are proportionate. If costs are disproportionate, then even a well-resourced party may hesitate before pursuing a valid claim or maintaining a valid defence. That party may simply drop a good claim or capitulate to a weak claim, as the case may be".*

In the recent case of *Pankhurst v White*, whilst not addressing the issue of referral fees, in examining the issue of excessive costs the Chancellor of the High Court was driven to comment that:

*"The facts of this case appear to show that access to justice for one party may well lead to a substantial denial of justice to the other".*

In addition to the impact that disproportionate costs have upon access to justice for defendants, the issue has a wider application to society in general. In his report Lord Justice Jackson recognised that the impact of costs does not stop with those involved in the process:

*"Ironically..opposing litigants are in many cases funded by taxpayers or council taxpayers: for example, the NHS Litigation Authority, local authorities, police authorities etc."*

Contrary to the argument put forward that insurers can well afford to pay the costs of individual claimants, the current regime means that millions of other individuals are called upon to pay the costs of those involved in personal injury litigation. Once legal costs become disproportionate a painless route to litigation for one section of the community is only obtained through the imposition of an excessive burden on society as a whole. As Lord Young stated in his comments at the beginning of his review of the 'compensation culture', over the past five years the NHS has paid £8bn to claimants, only a third of which has reached the injured individual. As he said in his report:

*"Now this is something that should be stopped. Money in the health service should be spent on health, not on these things."*

Many individuals and businesses are struggling to pay insurance premiums in the current economic climate. The raising of the insurance premium tax from a standard rate of 5% to 6% has raised concerns that the additional cost will make it harder to afford insurance and encourage more people to run the risk of not having cover. The current difficulties that the motor market is experiencing are causing particular concern. Recent reports of comments made by Graeme

Trudgill, head of corporate affairs at the British Insurance Brokers' Association, give some indication of the issues:

*"We all realise that rates will continue to rise unless something is done and that is why we are in front of the government explaining the issues. The market made a £1.5bn motor underwriting loss last year and you can't continue like that with personal injury claims going up 30% per annum, it is just completely unsustainable so things have to change".*

As these points indicate, whilst at first blush it may be perceived that the issue of referral fees is merely one that affects access to justice for claimants, this is much too simplistic a view. It is against the wider issues detailed above that referral fees should be considered including the impact of disproportionate costs on defendants' access to justice and the impact upon society as a whole. It is not just desirable, but essential, that in forming a view and making recommendations, the Legal Services Board takes into account these wider public policy issues if the regulatory objectives set out in the Legal Services Act 2007 are to be met, in particular,

- (a) the objective of protecting and promoting the public interest; and
- (b) the objective of improving access to justice, which as indicated above, is not merely an issue for claimants but must also be considered in the context of defendants.

### **Consultation Question 1**

#### **Conclusions – Personal Injury and Conveyancing**

##### **1. Do you agree with our analysis of the operation of referral fees and arrangements?**

There are a number of points raised within the analysis with which FOIL would take issue.

#### The Evidence in the Report

On page 32 of the consultation document the LSB states:

*"We judged it important to ensure that our analysis was founded upon both a deeper understanding of consumer views of referral fees and a proper economic*

*analysis of their impact upon the market. Vanilla Research and CRA (Charles River Associates) were therefore commissioned to undertake independent research for the Consumer Panel and the LSB respectively."*

Whilst applauding the desire to bring some economic and analytical rigour to the debate, FOIL is concerned that there are significant weaknesses in the research that has been produced and does not believe that it delivers the empirical evidence that the LSB was seeking in order to make well-founded recommendations.

In its analysis of the statutory regulatory objectives the LSB sets out its understanding of the obligation to protect and promote the interests of consumers. The document states:

*"The Act leads us to a wide definition of consumers and we take that definition to encompass anyone who might have recourse to legal services because of a legal issue".*

It appears from the work undertaken on referral fees that the LSB and the Legal Services Consumer Panel define consumers as individuals, rather than taking the broader approach of defining consumers as all users of legal services. The regulatory objective set out above is the only one which aims to protect those involved within the legal process. If 'consumer' is defined as an individual rather than a user it would appear that other types of legal client are outside the protection of the regulatory regime, without a voice. For FOIL, this would be a surprising aspect of the regulatory regime and it would be helpful if the LSB could clarify the definition.

Looking at the Vanilla Research report, it is based entirely on interviews and discussions with individual consumers of legal services. The primary aim of the research was to "explore, with potential and recent users of legal services that commonly involve referrals, what the advantages and disadvantages are for consumers". Another key aim was "to assess the impact of the marketing activities of claims management companies on those seeking access to justice and whether this affects some groups of consumers more than others". The report indicates that the report is based on the input from 25 personal injury claimants. The scope of the research undertaken is therefore extremely narrow. The conclusions reached can only be said to reflect the views of individual consumers and there is no recognition within the research that access to justice

is a two-sided issue of equal significance to defendants and claimants. Such an approach is inadequate to meet the full statutory regulatory obligations of the LSB to protect the public interest and to encourage access to justice for all, not just for claimants. The very small number of consumers involved in the research is inadequate and undermines the credibility of the conclusions reached.

The Charles River Associates (CRA) Report was commissioned to produce "modelling to build an assessment of the full economic impact of referral fees". The LSB report indicates that CRA were asked to "produce an analysis of the impact of six policy options and a review of the range of costs and benefits to be considered". In the light of this aim it might have been expected that the report would look not only at the current regime, but also include some detailed analysis of what the economic results would be if various policy options were adopted. For example, what effect would the removal of referral fees have upon claimant solicitors overheads and profits; what impact would this change have upon guideline hourly rates and the fixed costs regime; what would be the result if claimants had some responsibility for paying costs and therefore had some interest in the level of referral fees and their impact on costs? The CRA report satisfies itself that the current arrangements do not impact adversely upon consumers and does not examine in detail the economic impact of any of the changes which might be introduced. In a 114 page report an examination of the impact of the policy options for referral fees in personal injury claims takes up just two and a half pages. A statement at the beginning of the section indicates that "it is worth noting that since the [CRA report] concluded that there was no evidence that referral fees are causing consumer detriment, policy options focussed on altering referral fees are unlikely to bring benefits".

Whilst the CRA approach meets the regulatory objective to protect the interests of individual consumers, FOIL would raise again its concerns at the definition of 'consumer'. The CRA report is much too limited in its scope to meet the other statutory regulatory objectives of protecting the public interest and ensuring access to justice for all parties. In examining only the interests of consumers it fails to provide the "definitive evidence" that the LSB was seeking and is not a firm foundation for the conclusions reached in the LSB report. There is no economic analysis at all of whether the current consumer benefits could be retained whilst eliminating or reducing the cost of referral fees, surely a key question in achieving a balance in the interests of claimants, defendants, and society as a whole.

## The Conclusions in the Report

The preliminary hypothesis of the LSB is that “the simple solutions of an outright ban or a laissez faire free for all are both unacceptable”. In reaching the conclusion that a ban would be “wholly disproportionate” the LSB has considered a number of issues, in particular, the impact of referral fees on the price of legal services; access to justice; and quality of the service. The Legal Services Board states that:

*“In personal injury cases – the area in which referral fees are most common – we found no evidence that quality had diminished or that prices had risen. Additionally, evidence suggested that the extra impetus on marketing means that justified claims are being made that would not otherwise be pursued – contributing to the widening of access to justice”.*

FOIL does not accept that the current evidence available to the LSB supports the preliminary hypothesis, in particular, with regard to the issues of impact on price and access to justice. On the contrary, on both issues there is evidence that referral fees have a negative impact.

### **The impact of referral fees upon the price of legal services**

On the issue of the impact of referral fees on costs the LSB report states that there is:

*“no evidence that increases in referral fees have led to an increase in the price of legal services”.*

On this crucial issue the CRA report summarises its views as follows:

*“There was no evidence that increases in referral fees had led to an increase in the price of legal services. Price does not play a strong role in personal injury cases because of the prevalence of “no-win-no-fee” agreements but the majority of motor cases go through prescribed cost and fast track regimes in which legal fees are regulated.”*

The report goes on:

*"We note that it is possible that increases in referral fees lead to an increase in prices. However, the vast majority of cases are conducted through the predictable costs scheme or the fast track scheme in which the level of legal costs are prescribed. Given these prices are fixed, referral fees do not affect the price of legal services. (It is possible that there could be an impact if the price of legal services is partly determined by factors which include the cost of referral fees. Assessing the method by which the price of legal services is determined for the regulated schemes is beyond the scope of this report)".*

With respect, the statement that, as the prices of legal services are fixed, referral fees do not affect the price takes a very simplistic view of the market. The issue which CRA states is outside the scope of the report – the extent to which referral fees affect fixed costs and guideline hourly rates – is critical to the issue of whether referral fees affect the price of legal services. The ACCC, (the body with responsibility for making recommendations on the guideline hourly rates), in conclusions it put forward when advising on the 2010 rates, stated that marketing costs, including referral fees, account entirely for the fact that claimant solicitor rates are 20-35% more than defendant solicitor rates. That difference is then factored into the guideline hourly rates, and into fixed costs. The Legal Services Consumer Panel accepts in its report that "referral fees appear to be reflected in centrally set fixed fees and hourly rates", and, indeed, argues that it is essential that referral fees are factored into recoverable costs to ensure that cases are taken on. It therefore seems incontrovertible that referral fees do affect the price of legal services even though prices are fixed, yet this is an issue which CRA believes is outside its detailed economic analysis.

At its simplest, figures within the LSB report, supplied by the SRA, indicate that the payment of referral fees accounts for up to 20% of the income of just under 70% of law practises that pay referral fees. On the basis that, according to Lord Young, the claims management market is worth nearly £300m per annum it does not seem appropriate for recommendations to be made without examining what the economic impact would be on hourly rates, and legal costs overall, if sums of this magnitude were taken out of the system.

In formulating its conclusions the LSB has been considerably influenced by the fact that in personal injury cases consumers have no interest in the level of costs

incurred because they are very rarely called upon to pay them. As the LSB states:

*"In the personal injury market, concern around price is likely to be mitigated by the impact of conditional fee agreements (CFAs or no-win, no fee") and other funding models. Indeed the majority of personal injury cases do not involve any self-funding. Research by the Ministry of Justice showed that only 6% of consumers funded their own accident or injury legal action with 4% funding in other ways. The remainder had their case funded for them..."*

The report indicates:

*"Whilst cost is less of an issue in the personal injury arena, this may change with proposals to remove the recoverability of success fees and ATE premiums".*

FOIL believes that to state that cost "is less of an issue in the personal injury arena" is to miss the serious impact that excessive costs have upon the personal injury process and upon society in general. It is certainly the case that in many situations consumers who do not appreciate where the costs of the claims fall ultimately, do not care about cost: as one consumer remarked to the Legal Services Consumer Panel,

*"I wouldn't give a monkey's [about excessive referral fees] because that's the insurance company that's going to sort it out"*

However, in fact, contrary to that view, referral fees already impact upon consumers directly. Under the complexities of Part 36 and flexible costs orders claimants may be required to pay a portion of their own or their opponents' costs. Lord Justice Jackson noted in his report that he was aware of one claims management company which charged its clients £379 out of damages received. Even in cases where consumers are not directly affected it is misguided to conclude from the consumer indifference expressed in the above quote that costs are "less of an issue". Costs are very much an issue as an examination of the wider issues surrounding personal injury litigation will show.

Even in focusing exclusively on claimants' interests, the LSB report makes an important point. A change to the rules on recoverability requiring claimants to pay some of their own legal costs will create an environment in which consumers are directly affected by the costs of their legal services. Bluntly, if the rules on

recoverability change consumers will 'give a monkey's'. The implications of this change are not covered at all in the LSB consultation document or in the research upon which it relies. FOIL believes that this reflects a degree of complacency: how can the LSB be sure that consumers will remain unaffected by referral fees when a change to the rules already being considered by the government will routinely expose them to a direct costs liability?

Finally, it is hard to reconcile the LSB's conclusion that referral fees do not impact on price with the comments in the foreword by the Chief Executive, Chris Kenny, to the effect that in the future, "New ABS firms may emerge that capture the entire value chain of both customer acquisition and legal advice, so reducing excess profits". There is no explanation within the LSB report of why this explicit acknowledgment of excess in the system is not explored further.

### **Access to Justice**

A significant increase in access to justice is a key argument put forward by the supporters of referral fees. In its report the Legal Services Consumer Panel indicates that:

*"for personal injuries, introducers may improve access to justice by increasing awareness of the right of those who have suffered accidents to claim compensation and by facilitating the claims process".*

The above statement appears to be based on the fact that since 2004, when the ban on referral fees was lifted, motor claims have risen substantially, from 402,892 in 2004/5 to 625,072 in 2008/9. This rise is against a backdrop of a reduced road traffic accident rate of 18% over the same period. When the two statistics are considered together the rise in claims is almost 100%. The CRA report indicates that the whole increase in claims cannot be attributed to the introduction of referral fees and sets out several additional factors which may have had an influence. There must also be a concern that some of the increase is due to the prevalence of fraudulent claims: the Insurance Fraud Bureau has reported that there may have been as many as 30,000 fraudulent claims in 2009.

Aside from motor, the data relied upon by the Consumer Panel shows that other types of claim have been stable and even declined over the same period. As the report notes:

*"By this account it is difficult to argue that claims management companies have made a significant difference to the number of litigated claims in these areas since the introduction of CFAs".*

The CRA report also highlights the rise in motor claims since 2004 and notes that EL claims have not increased in a similar manner. The report appears to suggest that this is because there is less advertising activity for EL claims but this is difficult to understand as much claims management advertising is not restricted to specific types of claim, and it has been reported that EL and PL claims account for 65% of claims attracted by claims management advertising.

In truth, although access to justice is advanced as a benefit of referral fees, the evidence supporting that assertion is far from clear cut. In its report the LSB takes the rather modest stance that "we cannot conclude from the evidence that access to justice is harmed by referral fees. It is indeed arguable that access to justice has been improved". Following its interviews with consumers Vanilla Research also takes a rather modest view of the access to justice benefits of referral fees, stating,

*"In terms of awareness of the existence of Personal Injury claims, there is a sense from the interviews that most consumers now know that they are often an option, and so those with what might be considered the most serious injuries (for instance broken bones, hospital stays, head injuries) were mostly already intent on making a claim, and any marketing activities just helped them choose a firm. The marketing may have helped their choice of firm, but was not necessary to bring them into the justice system.*

FOIL would argue that it is not adequate to conclude that, as there is no evidence that claimants' access to justice is not harmed by referral fees, the impact of referral fees upon access to justice is at worst neutral, and at best, may be positive. To conclude thus is to ignore the fact that referral fees are one of the factors which significantly increase costs, which in turn leads to a denial of access to justice for defendants.

Lord Justice Jackson does not accept that referral fees are necessary for access to justice. In his view claimants with personal injury claims would be well aware of their right to claim damages even without the existence of claims management companies. He did not accept that access to justice was denied or restricted prior

to 2004 when the ban on referral fees was lifted. Lord Justice Jackson believes that consumers could be made aware of their rights by other means, without the need for referral fees. There is no examination of this solution to access to justice in the CRA report. The report contains the rather simplistic comment that "in as far as there is evidence that referral fees have increased claims, banning them would be detrimental". This ignores the wider access to justice issues and ignores Lord Justice Jackson's argument that the same benefits could be obtained without the expense of referral fees, thereby making the whole process cheaper.

All of the research and both of the reports on referral fees work on the basis that an increased level of claims is a positive benefit. Whilst this may be the case if the increase is due to increased awareness of legal rights and the ability to enforce them, there is no examination in the reports of the murkier side of claims management practice within some companies. An individual who has suffered an accident and has a potential claim is a commodity with a value and vulnerable people, at a time when they have already suffered a trauma, can find themselves put under excessive pressure to bring a claim, often experiencing numerous 'cold calls'. FOIL believes that the impact of this kind of activity should have formed part of the research undertaken by the LSB. As Lord Justice Jackson indicated;

*"In my view it is offensive and wrong in principle for personal injury claimants to be treated as a commodity....Indeed, the very language of the claims management industry characterises personal injury claims as a commodity. Strong cases ready to be pursued as described as "oven ready"."*

## **Consultation Question 6**

### **Recommendations for improving transparency and disclosure**

#### **6. Will the proposals assist in improving disclosure to consumers?**

In its report the LSB indicates that it believes that "the Consumer Panel's recommendation about transparency is crucial. There needs to be transparency to the individual client".

Although the consultation question asks whether the proposals will improve disclosure to consumers, FOIL believes that a more relevant question would be to ask, in the event that greater transparency is achieved, what benefits that will bring?

As stated above, under the present system a key problem is that consumers have no interest in the level of costs, including referral fees. In this situation it is hard to see what the key recommendation of the LSB - of greater transparency - will achieve. If consumers do not care about the level of referral fees, providing them with more information about them will not affect behaviour. The recommendation will have no impact upon the main problem with referral fees – a significant increase in cost.

## **Conclusion**

As the LSB indicates in its report, in its view the debate on referral fees to date has been characterised by powerful representations but a lack of definitive evidence. It sets out to fill that void with strong empirical evidence but disappointingly, in FOIL's view, the evidence gathered represents an opportunity missed. The research and evidence suffer from two major weaknesses: they are exclusively focussed on the interests on the individual consumer rather than looking at the wider issues included in the regulatory objectives; and they focus on a examination of the current system without analysing in detail the likely impact of a change to the rules, to include a ban or a restriction on referral fees. These weaknesses make it unacceptable to rely upon the evidence in support of a recommendation that referral fees should continue to be permitted in the personal injury market.

The LSB report contains the views of various bodies and commentators on referral fees. It is notable that the two independent views expressed with regard to personal injury work – by the Law Society and Lord Justice Jackson - both support a ban. The report indicates that “of course, the consumer voice should not be lost amongst competing claims within the legal services market”. In FOIL's view, to summarise the views expressed in this way is to underestimate the authority, weight and respect represented by both the Law Society and Lord Justice Jackson. It is not appropriate to characterise the views of the Law Society and Lord Justice Jackson as merely two voices amongst many: these are independent, major players in the debate and their views and recommendations deserve more serious consideration. Lord Justice Jackson, in particular, expresses strong views in a report which has attracted wide-spread approval for its thoroughness and rigour, including support from the government.

On the issue of referral fees FOIL agrees with the comments and recommendations contained in Lord Justice Jackson's report on civil funding. In essence,

- referral fees are one of the factors which contribute to the high costs of personal injuries litigation;
- referral fees are not necessary for access to justice (and indeed, are detrimental to access to justice for defendants);
- referral fees are not of benefit either to claimants or to the providers of legal services and the only winners are the recipients of referral fees.

FOIL supports Lord Justice Jackson in calling for referral fees to be banned, or, failing that, for the levels of referral fees to be strictly controlled.