

Referral Arrangements

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Foreword

The Legal Services Consumer Panel has found itself alone in approaching the issue of referral fees from the client's view. Before now, assertions have been made about the consumer interest. Yet – as we found from our research – consumers were largely completely unaware that such fees have been paid, let alone having formed a view as to whether they would want their business handled in this way. Many were surprised – some shocked – to learn that the much trusted brand of “lawyer” employed commercial practices they found quite normal in other aspects of their lives. Furthermore, in our call for evidence for this project, while we were well served by submissions from introducers, lawyers and economists, there was largely silence from other consumer representatives.

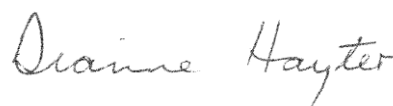
This points up two lessons. One is how essential it is for the Consumer Panel to interrogate regulatory initiatives on behalf of consumers, who otherwise may be unaware of the actual issues, let alone of plans for intervention. The second is for all the front line regulators proactively to search out the consumer experience and views. This must be an essential, not an optional, aspect of their duties.

For the particular issue of referral fees, it will come as no surprise that our first two recommendations – “reveal” and “regulate” – demand that providers and regulators stand in the shoes of consumers to protect their interests. Firstly, it is essential that those who pay know and approve of the payments by lawyers to introducers. Secondly, since existing requirements for such transparency, in the case of

conveyancing, have been unenforced to date, regulators must prioritise the enforcement of these rules. This cannot be left to consumers as they are blissfully unaware of the fact and size of such payments. It is also only the regulators who can ascertain whether the degree of reliance on the resulting flow of work to any one firm might prejudice the essential independence of a lawyer's advice.

With these two vital caveats, of full transparency and effective regulation, the Panel's third recommendation – “retention” – can stand. We have asked the regulators to put in place appropriate steps so that, in three years' time, they can measure whether clients have, by then, been able to see and approve any such payments, while regulators will be able to judge the effect of these on the business model of any regulated firm.

The Consumer Panel is committed to the availability of quality, reasonably priced legal advice, and access to justice. If referral fees can assist this, while retaining the independence of legal advice, then there is no reason why they should not remain part of the legal provision scene.



Dr Dianne Hayter
Chair, Legal Services Consumer Panel

1 Executive Summary

A common feature

- 1.1. The reach of referral arrangements in legal services goes far and wide. Nearly a quarter of consumers are referred to their lawyer by another organisation, while one in five solicitor firms in England and Wales have referral relationships with 8,340 different introducers in 76 areas of law.
- 1.2. For the purposes of this investigation, referral arrangements are defined as “*any arrangement under which business is received from, or referred to, a third party*”. Often a fee will exchange hands, but not always. The third party might be a lawyer, or an introducer from outside the sector.
- 1.3. This report focuses on the two markets where referrals happen most often: conveyancing and personal injury. In the first, estate agents refer buyers and sellers to conveyancers for fees typically in the region of £100-300. In the second, claims management companies, insurers and trade unions refer claimants for fees ranging from £200 to £1,000.

A divisive issue

- 1.4. This practice divides the profession, many of whom would prefer obtaining work via commercial introducers was not allowed. Most of the controversy centres on referral arrangements where money changes hands. Some take a principled view that paying referral fees is inherently unethical for lawyers. Unease is most keenly felt in personal injury claims, where some consider it is morally wrong to make a profit from selling vulnerable people as if

they were tradable commodities. Others point to the risks of conflicts of interest, poor quality work and higher prices.

- 1.5. However, there are also strong dissenting voices, which maintain introducers perform valuable access to justice and that referrals do not harm consumers. This viewpoint sees lawyers as out-of-touch at best, or at worst, guilty of protectionism.
- 1.6. Notably, the views of consumers have so far not been heard in this debate. The Panel has watched with bemusement as commercial organisations on both sides of the fence claim to speak on their behalf.

The Consumer Panel's investigation

- 1.7. The Consumer Panel's vision is for a market where everyone can access high quality and affordable legal services that meet their needs. An evidence-based approach, using market data, stakeholder views and consumer research, has been taken to assess the impact of referral arrangements on consumers.
- 1.8. Referral arrangements go to the heart of this vision because of their inherent influence on issues such as access to justice and competition. The consumer interest in connection to referral arrangements relates to three key topics:
 - Do they affect the independence of legal advice or lead introducers to recommend unsuitable providers?
 - Do they improve access to justice?

- What are the competition effects in terms of quality, price and choice of suppliers?

The Panel's verdict

- 1.9. The Panel has its reservations about referral arrangements and considers that action is needed to tackle concerns which cause, or have the potential to cause, harm to consumers. This report identifies those concerns and suggests some corrective actions. Nevertheless, the Panel recommends that referral arrangements continue to be permitted, as in both the conveyancing and personal injury markets the worst of the alleged problems are not substantiated by the evidence. Further, the marketing and the hand-holding role performed by claims management companies and not-for-profit bodies has widened access to justice.
- 1.10. A summary of our findings under the three key topics is provided below.

Independence

- 1.11. Opponents of referral arrangements argue that the independence of lawyers is compromised because they do not wish to harm their commercial arrangements with introducers by providing advice to clients that might risk those arrangements.
- 1.12. Three conditions need to exist to produce biased advice: lawyers suffer an unequal power relationship with introducers; clients' freedom of choice is constrained; and the interests of introducers and consumers are not aligned.
- 1.13. The data indicates that law firms are not over-reliant on work coming from a single introducer – the key factor that would create the opportunity for introducers to exert improper influence. For example, smaller firms are most likely to rely on a single introducer for referred work, but just 1% of sole practitioners obtain more than

50% of their income from just one or two sources. Furthermore, despite an intensive inspection regime, the Solicitors Regulation Authority has uncovered very few breaches of its independence rules.

- 1.14. It is possible to identify theoretical risks where biased advice results because the incentives of introducers and consumers are not aligned. For example, a conveyancer might seek to protect a property sale and with it the estate agent's commission by turning a blind eye to a planning issue. In a personal injury case, in order to protect their cash flow a lawyer might encourage a client to accept a lower settlement offer than they would expect if their case had been fully investigated.
- 1.15. However, the evidence does not substantiate these concerns. In the conveyancing example, the data shows that problems identified by lawyers rarely causes house sales to fall through, while the prospect of discovery should act as an effective deterrent. With respect to under-settling personal injury claims, overall payouts in claims involving road traffic accidents have increased by 7.4% over the last decade.
- 1.16. In personal injury cases, conflicts are created by the way in which lawyers are remunerated, not the referral fee itself. Referral fees might exacerbate deeper market imperfections, but the appropriate remedy is to tackle the root cause of the problem, not its symptom.
- 1.17. The Panel has the following concerns in relation to independence:
- It appears quite common practice for introducers to operate processes, such as closed bids or auctions, that mean work is referred to firms paying the highest referral fee, rather than an objective recommendation based on the client's needs. This increases the size of referral fees and could mean

that consumers are referred to expensive or unsuitable law firms.

- The Panel's consumer research, and research by Office of Fair Trading, has revealed problems with estate agents putting pressure on consumers to use their recommended lawyer. Similarly, in personal injury, there remain problems with cold-calling by claims management companies, while the controversy over whether before-the-event insurers should be able to nominate a lawyer needs resolution.
- Persistent non compliance with disclosure rules by both lawyers and estate agents. For example, a survey of estate agents by the Office of Fair Trading showed only 53% informed customers of the size of referral fee. Inspections by the Solicitors Regulation Authority found that 43.2% of solicitors failed to disclose their financial arrangements with introducers.

Access to justice

- 1.18. In the case of conveyancing, virtually all consumers need a lawyer and thus will find one eventually, although introducers may help them to do so more efficiently.
- 1.19. However, 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. Even some opponents of referral fees accept that claims management companies have brought more people into the justice system, although they argue that people now know they can make a claim so that this benefit no longer applies, and that relentless marketing fuels an unhealthy "compensation culture".
- 1.20. The debate takes place against a backdrop of significant unmet legal need, particularly among the socially excluded. Consumers' ability to access justice is highly dependent

on how effectively they are connected to legal advice. The advice sector cannot fill the gap alone and is, by its nature, a reactive service. By contrast, commercial introducers reach out to the public through marketing.

- 1.21. The Panel's consumer research shows that people value the activities of claims management companies. Road traffic accident claims data also suggests that permitting payment of referral fees to claims management companies has contributed to more people bringing claims. This would suggest a positive impact on access to justice.
- 1.22. In the consumer research, even among personal injury claimants there was an undercurrent of hostility towards the so-called "compensation culture". Participants had the view that people with more serious injuries were already intent on making claims. Those with less severe injuries were helped by introducers (mainly claims management companies) to bring claims. However, insurers settle over 90% of road traffic accident claims; this seems to suggest that referral fees have not led to invalid claims, at least on any great scale.

Competition

- 1.23. Referral arrangements mean that competition in legal services happens at two levels: between law firms and introducers to attract consumers; and between law firms to occupy valuable spots on introducer panels.
- 1.24. Consumers are not driving competition between law firms through their purchasing power. However, introducers can stimulate competition by exercising a filtering function that matches their customers to suitable legal services providers. But do introducers filter law firms on the same grounds as a consumer would do?
- 1.25. To examine this we considered the impact of referral arrangements on:

- the quality of legal services
- the price of legal services
- choice of providers, as reflected in the diversity of the supplier base

Quality

- 1.26. Opponents of referral fees argue that they are squeezing law firms' profits to the extent that firms are reducing client care. However, levels of satisfaction with outcomes and service are both high – at over 90% - and comparable regardless of the way in which consumers select lawyers. Indeed, in some cases investment in IT and case management systems, which the regular flow of work guaranteed by introducer panels makes possible, has improved standards and led to innovation.
- 1.27. There is some evidence of dissatisfaction among personal injury claimants and clients using “factory firms” (which process volume work) but this does not seem to impact on the outcome of legal advice. Any reduction in quality experienced with such businesses is a function of the volume business model, not the referral fee itself. Regulators must ensure standards are maintained above a minimum floor, but as in all markets consumers make trade-offs between price and quality.

Price

- 1.28. Opponents of referral fees argue that introducers make easy money for little effort and demand excessive fees from lawyers in order to secure work. If this were true, in markets where consumers pay for legal services, excessive referral fees should be reflected in prices charged to clients. However, conveyancing rates charged to clients are actually lower among firms paying referral fees - £543 compared to £687.
- 1.29. The impact of referral fees on the costs of personal injuries litigation is contested by

lawyers and insurers. Economists agree that referral fees account for the 30% gap in hourly rates charged by claimant and defendant solicitors. The size of referral fee is likely to reflect the value of the referral to lawyers, rather than the introducer's costs. However, while insurers argue referral fees are excessive, the Advisory Committee on Civil Costs has concluded that claims management companies do not make excessive profits.

Choice

- 1.30. The Panel does not favour one business model over another, but recognises that a diversity of suppliers promotes competition by increasing consumer choice. The increasing amount of legal work allocated via an introducer's panel of law firms raises competition concerns - there is little change in panel membership and the entry requirements limit access for smaller firms: access to panels can be granted on the basis of who pays the highest referral fees, while capital is required to invest in IT and case management systems.
- 1.31. The impact of panels on competition should be examined further. However, it is likely that consumers will always access legal services through multiple routes. Furthermore, lawyers are starting to challenge introducer panels, as seen by the emergence of comparison websites and solicitor collectives.

Alternative Business Structures

- 1.32. It is important to future-proof an analysis of referral arrangements as legal services are in flux. Alternative Business Structures (ABS), when introduced from 6 October 2011, will allow law firms to be owned by non-lawyers and be able to provide both legal and non-legal services.
- 1.33. It is likely that some models of ABS – such as an introducer-owned law firm or a full multi-disciplinary practice – will remove the

need for referral arrangements altogether. The key risk is that they will provide a mechanism for legitimate but less transparent referrals. This is worrying as different functions within ABS firms could have competing interests, for example if estate agents (acting for sellers) and conveyancers (acting for buyers) provided services under a single roof.

- 1.34. It would be difficult to ban referral arrangements in an ABS world without distorting competition. The need to pay referral fees would disappear should introducers and lawyers become part of the same business, making it harder for traditional law firms to compete.
- 1.35. In the event of a ban, owners could exploit the current exemption in the solicitors' code of conduct for disclosure in lawyer-to-lawyer referrals as a means of circumventing regulatory requirements applied to traditional law firms. Therefore, there should be common disclosure requirements for all ABS firms.

The way forward

- 1.36. Our analysis makes some broader points about the ingredients needed to regulate referral arrangements in order to ensure good outcomes for consumers. We also make twelve recommendations containing specific actions to address the concerns identified (see box overleaf).
- 1.37. The Panel's recommendations are built on three principles:
- A well-designed regulatory regime based on an appropriate mixture of high-level outcomes and prescriptive rules. An outcomes-based approach is better placed to deal with the wide variety of referral arrangements and keep pace with market developments. There is also the need for a consistent and joined-up approach to regulating both lawyers and introducers.

- Transparency should continue to be the central feature of the regulatory regime. It alerts consumers to the possibility of conflict, counters pressure selling, encourages consumers to shop around and helps regulators to monitor the market. However, transparency is not a panacea and its limitations need to be understood by regulators.
- Active enforcement of the rules, backed up by penalties that serve as a strong deterrent. Non compliance with disclosure rules is rife, but policing of introducers – the crucial decision point for consumers - is light-touch. Further transparency requirements, such as the written consent of clients, combined with mystery shopping should help to address these problems.

Next steps

- 1.38. This report is a formal response to advice requested by the Legal Services Board, which will now consider it, together with other sources of evidence.
- 1.39. The Consumer Panel will continue to be closely engaged in the decision-making process to ensure that regulation of referral arrangements is designed around the interests of consumers.

Recommendations

The Panel's advice to the LSB is as follows:

- Referral arrangements should continue to be permitted, but the LSB should review the market in three years time.
- The LSB should lead a collaborative initiative to achieve a consistent set of regulatory requirements within and outside the legal sector.
- The LSB should monitor through surveys the impact of referral arrangements on levels of client satisfaction with outcomes and service.
- The LSB should consider further measures to improve transparency to place the consumer at the heart of referral transactions. This could include obtaining a client's written consent for referred conveyancing work.
- Approved Regulators should systematically collect data on referral arrangements.
- Approved Regulators should consider prohibiting firms from entering into bidding auctions or similar processes for referred work.
- Approved Regulators should issue guidance on the circumstances under which a dependency on referral arrangements creates a risk of conflict.
- Licensing Authorities should introduce disclosure rules for all types of ABS.
- The OFT should consider investigating whether competition in relation to introducer panels is working effectively.
- The OFT should provide guidance on the likely application of general consumer law to referral arrangements.
- The OFT, with its partners in trading standards, should carry out mystery shopping of pressure selling by estate agents and, if necessary, take enforcement action.
- Business acquisition costs should be openly factored into the calculation of fixed fee regimes (developed by the Ministry of Justice) and Guideline Hourly Rates (set by the Master of the Rolls).

2 Introduction

A common feature

- 2.1. Although many people shop around for a car or an energy supplier, most will not actively search the market for a lawyer. Instead, most consumers will choose a lawyer based on a recommendation from someone they know or go back to a lawyer they have used before.
- 2.2. However, nearly a quarter of consumers find a lawyer via a referral from an intermediary who is unknown to them personally. Such introducers might be a trade union, a charity, a claims management company or a commercial business such as a bank, insurer or estate agent. In many cases, the lawyer then makes a payment or provides some non-monetary benefit to the intermediary for the introduction. Such arrangements are the subject of this report.
- 2.3. Referral arrangements arise when introducers spot a market opportunity to bring together consumers and providers more effectively. They are common across the economy, in areas such as financial services, property and travel. That they are commonplace in legal services is not surprising given that most consumers use lawyers only rarely, while the specialised nature of the law and a lack of easily comparable information make it difficult to compare the quality of lawyers or their firms. From the viewpoint of lawyers, introducers can ensure a regular flow of work and help overcome their reticence, or inability, to advertise directly to the public.
- 2.4. Referral arrangements in the legal world can involve a wide range of actors and take many forms. One in five solicitor firms

have referral arrangements with 8,340 different introducers in 76 areas of law. This report focuses on the two markets where referrals happen most often: conveyancing and personal injury. In the first, estate agents refer buyers and sellers to conveyancers for fees typically in the region of £100-300. In the second, claims management companies, insurers and trade unions refer claimants to solicitors for fees ranging from £200 to £1,000.

- 2.5. In addition to making referral payments, lawyers can also be recipients of referral fees, when they refer their clients to businesses such as surveyors, financial advisers or medical reporting agencies.

A divisive issue

- 2.6. Referral arrangements, especially those involving fees, are a divisive topic. Large parts of the legal sector consider that paying referral fees cheapens the profession and runs counter to the core duty of lawyers to act in the best interests of clients. Particular unease is felt in the context of personal injury claims where some consider it is simply morally wrong for businesses to make a profit from selling vulnerable clients as if they were tradable commodities. Some of the language used to describe claims management companies - “parasites” and “traffickers in human misery” – are colourful illustrations of the depth of feeling. While this language is at the extreme end, the underlying sentiment is shared by many.
- 2.7. The role played by referral fees in the miners’ compensation scandal, combined with the growing size and spread of referral

fees, has given more urgency to calls for them to be banned, as they were for solicitors prior to 2004 (although that ban was widely flouted). Indeed, barristers and immigration advisers are prohibited at the present time from paying or receiving referral fees.

- 2.8. Supporters of a ban include members of the senior judiciary, legal representative bodies and insurers. Notably, the Jackson Report on Civil Litigation Costs recommended that referral fees be banned in personal injury cases, or as a fallback position, be capped at £200¹. The Office of Fair Trading (OFT) has concluded that there is more than a theoretical risk that referral fees introduce conflicts of interests for estate agents².
- 2.9. However, there are powerful dissenting voices - and not just from those introducers that gain financially from referral fees. In particular, the professions' regulatory arms that contributed to this investigation, with the exception of the Bar Standards Board, consider that effective regulation can successfully manage risks to consumers.
- 2.10. There are two points of common agreement: there should be a consistent approach across the legal sector; and the issue should be settled once and for all. We hope this report can help decision-makers to deliver on these objectives.

The consumer interest

- 2.11. Until now, the consumer voice in the debate has not been put forward. We have watched with some bemusement as organisations on both sides of the fence claim their policy position would achieve the best outcomes for consumers.
- 2.12. The Consumer Panel's vision for legal services consumers is a market where everyone can access high quality and affordable legal services that meet their needs, as follows:

- A competitive legal services market where consumers are empowered and have easy access to high quality legal services at a fair price
- All consumers have an equal access to legal services regardless of their personal circumstances
- Regulatory bodies have processes enabling them to take decisions which are in the consumer interest
- Consumers receive legal services from a diverse and competent workforce
- Consumer complaints are resolved quickly, fairly and cost-effectively

- 2.13. Referral arrangements go to the heart of many of these objectives, in particular access to justice and competition. Our analysis suggests that the consumer interest relates to three key questions:

1. Do referral arrangements affect the independence of legal advice or lead introducers to recommend unsuitable providers?

- 2.14. Opponents of referral arrangements argue they compromise the ability of lawyers to fulfil their overarching responsibility to act in the best interests of clients. It is felt that lawyers may be reluctant to take action that would harm the introducer's interests when these conflict with those of clients. Further, it is argued that introducers refer or pressure clients to use the lawyer that pays the highest referral fee, not the provider that is the best match for the consumer's needs.
- 2.15. On the other hand, supporters argue that the law is no different to any other market where similar conflicts exist but are successfully managed. Furthermore, the risks are exaggerated as the interests of introducers and consumers are aligned and the law is an ethical profession which is tightly policed.

2. What is the impact of referral arrangements on access to justice?

- 2.16. The focus of this part of the debate is on personal injury. Supporters of referral arrangements argue that marketing by claims management companies encourages people to bring claims who might not otherwise have done so. Furthermore, the hand-holding role provided by such organisations and not-for-profit bodies eases people through the claims process at a time when they are at their most vulnerable.
- 2.17. By contrast, opponents of referral arrangements suggest that consumers now know it is possible to bring personal injury claims and can easily find their way to a lawyer. It is argued that claims management companies trigger fraudulent claims and have fuelled an unhealthy compensation culture which deters people with genuine injuries from seeking redress.

3. What are the competition effects of referral arrangements?

- 2.18. Opponents of referral arrangements argue they dampen competition. Either referral fees add unnecessary costs which consumers end up paying, or law firms absorb the referral fee within their profits but compensate by reducing the quality of service they provide. It is alleged that introducers are too dominant in the market and allocate work to an ever decreasing number of large law firms, which disadvantages small firms and reduces choice for consumers.
- 2.19. The alternative view is that lawyers have to acquire clients somehow and sourcing work through introducers is more cost-effective than marketing their services directly. Introducers are keen to protect their brands, and can use their knowledge of the market and bargaining power to ensure that consumers receive good quality legal services at affordable prices.

This investigation

- 2.20. The Legal Services Consumer Panel started work in November 2009 and has a statutory responsibility to represent the interests of consumers of legal services. The referral arrangements investigation is our first major piece of work and has been undertaken in response to a formal request for advice from the Legal Services Board (LSB). The terms of reference for the investigation are reproduced in Annex 1.
- 2.21. The debate has provoked argument over many years, but with little evidence to back up the various assertions. Good argument is important, but the Panel's approach has been to base its analysis on robust and up-to-date evidence. Our main sources were:
- Consumer research by Vanilla Research - ten focus groups held across England and Wales plus ten one-on-one interviews with personal injury claimants. The full research report is available on our website.
 - Call for evidence – 71 individuals and organisations responded to a call for evidence issued in December 2009 - where consent was given, these submissions are available on our website. In addition, we held meetings with legal and other businesses to help build our understanding of the market.
 - An economic analysis from Charles River Associates (CRA) commissioned by the LSB. The review pays particular attention to the competition effects of referral fees and includes a cost benefit analysis of six policy options. CRA's report is available on the LSB website.
 - Stakeholder roundtable debate - in January, we hosted a debate with 22 individuals and organisations from the legal, claims management, insurance and property sectors.
 - A review of literature and surveys.

- 2.22. In undertaking our analysis, we have been mindful of the changing legal landscape. Relevant developments include the emergence of Alternative Business Structures, the new fixed recoverable costs regime for certain road traffic accidents and the Jackson Report on Civil Litigation Costs. Decisions by legal regulators on referrals will have implications for businesses outside of the legal sector and we have therefore sought to factor this in our analysis.
- 2.23. Finally, we had considered examining referral arrangements between lawyers, in addition to referrals between lawyers and introducers from outside the sector. The evidence suggests these are less frequent and more informal than referrals from outside the legal sector. They would also appear to present fewer risks to consumers since lawyers are subject to regulatory requirements and referrals incentivise lawyers to transfer work which lies outside of their expertise.
- 2.24. There is a particular controversy in criminal advocacy where solicitor advocates are said to enjoy an unfair competitive advantage as they are permitted to pay referral fees to introducers, while barristers are prohibited from so doing. However, this is technically a “fee-sharing” relationship rather than a referral arrangement as defined in this review. The CRA study deals with it comprehensively; the Panel does not wish to add to this analysis.

Structure of the report

- 2.25. Chapter 3 sets out the current market picture describing: a working definition of referral arrangements; the prevalence of referral arrangements; typical referral arrangement models; and regulatory requirements.
- 2.26. Chapters 4-6 examine each of the three key policy areas set out above.
- 2.27. Chapter 7 discusses the implications of Alternative Business Structures.
- 2.28. Chapter 8 discusses the ingredients for smarter regulation of referral arrangements.
- 2.29. Finally, Chapter 9 draws together our conclusions and recommendations.

Thank you

- 2.30. The Panel is grateful to the many individuals and organisations that made submissions, met with us and answered our questions. A full list of all the individuals and organisation from which we received input is provided in Annex 2.
- 2.31. Finally, we would like to thank those individual consumers who participated in our focus groups and interviews for sharing their experiences.

3 Market Picture

Introduction

- 3.1. This section of our report sets out the market picture, describing:
- A working definition of referral arrangements
 - Prevalence of referral arrangements
 - Typical referral arrangement models
 - Regulatory requirements
- 3.2. The available market data is slim, so the description of the market is impressionistic in parts and draws together evidence from various sources. However, the Claims Management Regulator and the Solicitors Regulation Authority (SRA) both collect useful information as part of their annual data return exercises; we are grateful to them for sharing this. In the absence of other information, the following picture focuses on solicitors.

Definition of referral arrangements

- 3.3. For the purposes of this investigation, referral arrangements are defined as “*any arrangement under which business is received from, or referred to, a third party*”. The third party might be another lawyer, or an introducer from outside the sector.
- 3.4. The above definition does not represent our view of what should fall within the scope of regulation. Rather, we deliberately chose a broad definition in order to examine the full range of arrangements in place, on the grounds that some types might be more acceptable than others. Only by examining the breadth of

arrangements is it possible to decide which to permit.

- 3.5. Much of the debate relates to “referral fees”. Referral arrangements usually involve payment in return for the introduction of business, but some do not involve any monetary reward. According to data collected by the SRA³, 10% of law practices with referral arrangements do not pay a fee or other consideration. Problems around conflict of interest can stem from the dependency on an introducer for work, rather than the fee itself. This broader approach was welcomed by regulators including the OFT⁴ and SRA⁵.
- 3.6. Lawyers also receive income when they refer clients to a range of ancillary providers, such as surveyors, financial advisers or medical reporting organisations. We did not receive any evidence from legal or other organisations about referrals flowing in this direction. However, while not a major focus of this investigation, the analysis notes where such arrangements could be abused.

Prevalence of referral arrangements

- 3.7. Research by the Ministry of Justice suggests that 23% of consumers found their lawyer through a referral from another organisation⁶. Despite this, consumer awareness of referral arrangements is very low. Research by the SRA found that only 5% of consumers said they had been involved in a one⁷. The Panel’s own qualitative consumer research supports these findings: while consumers were aware of referrals and referral payments across the economy in general, they were

less aware, and even surprised, that they occurred in the legal world.

- 3.8. SRA data for 2008/9⁸ indicates that 2,044 Law Practice Head Offices (19.9%) had referral arrangements with 8,340 different organisations. These organisations include names that might be expected, such as claims management companies, estate agents, insurers and trade unions. However, there were also more imaginative relationships, for example with

hairdressers, funeral directors, physiotherapists and sports clubs.

- 3.9. The prevalence of referral arrangements varies by size of law firm, with larger firms far more likely than sole practitioners and firms with 2-4 partners to have them (see Table 1). Solicitors reported referral arrangements in 76 different areas of law, the top ten are listed in Table 2. This is followed by a description of the two markets covered in this investigation.

Table 1 - Referral arrangements by size of law practice

Law Practice Size	Law Practices with Referral Arrangements	Number of Law Practices	as % of Law Practices
Sole Practitioner	494	4543	10.9%
2-4 Partners	930	4283	21.7%
5-10 Partners	393	928	42.3%
11-25 Partners	154	320	48.1%
26-80 Partners	51	133	38.3%
81+ Partners	22	59	37.3%
Total	2044	10266	19.9%

Source: SRA

Table 2 – Referral arrangements by area of law

Area of Law in Referral Fee Arrangement	No. of Law Practices	as % of Law Practices
Conveyancing Residential	1043	52.40%
Personal Injury	854	42.90%
Employment	80	4.0%
Multiple Areas of Work	62	3.1%
Litigation - General	61	3.1%
Wills & Probate	61	3.1%
Family	53	2.7%
Medical Negligence	48	2.4%
Commercial Property	46	2.3%
Business Affairs	42	2.1%

Source: SRA

Conveyancing

- 3.10. The Ministry of Justice survey suggests that 29% of consumers find their conveyancer via a referral from another organisation⁹. The OFT's research supports this finding: estate agents recommended conveyancers to 51% of sellers and 44% of buyers. Of these, just over half of sellers and a little under half of buyers used the recommended provider¹⁰.
- 3.11. SRA data indicates that 52.4% of solicitor firms practising conveyancing have referral arrangements¹¹. Estate agents are the main source of referrals. The size of referral fee can depend on the value of the property, but typically ranges from £100-300¹². Estate agents are a focal point of property transactions and also refer clients to a range of other services, including mortgage brokers, surveyors and Home Information Pack (HIP) providers.
- 3.12. The structure of the conveyancing market is changing, with traditional law firms facing competition from national 'factory firms' processing volume work. Prior to 2004, some 90% of work was conducted by local firms while it is now only 60-70%¹³. Referrals are a core feature of the business model for such factory firms.

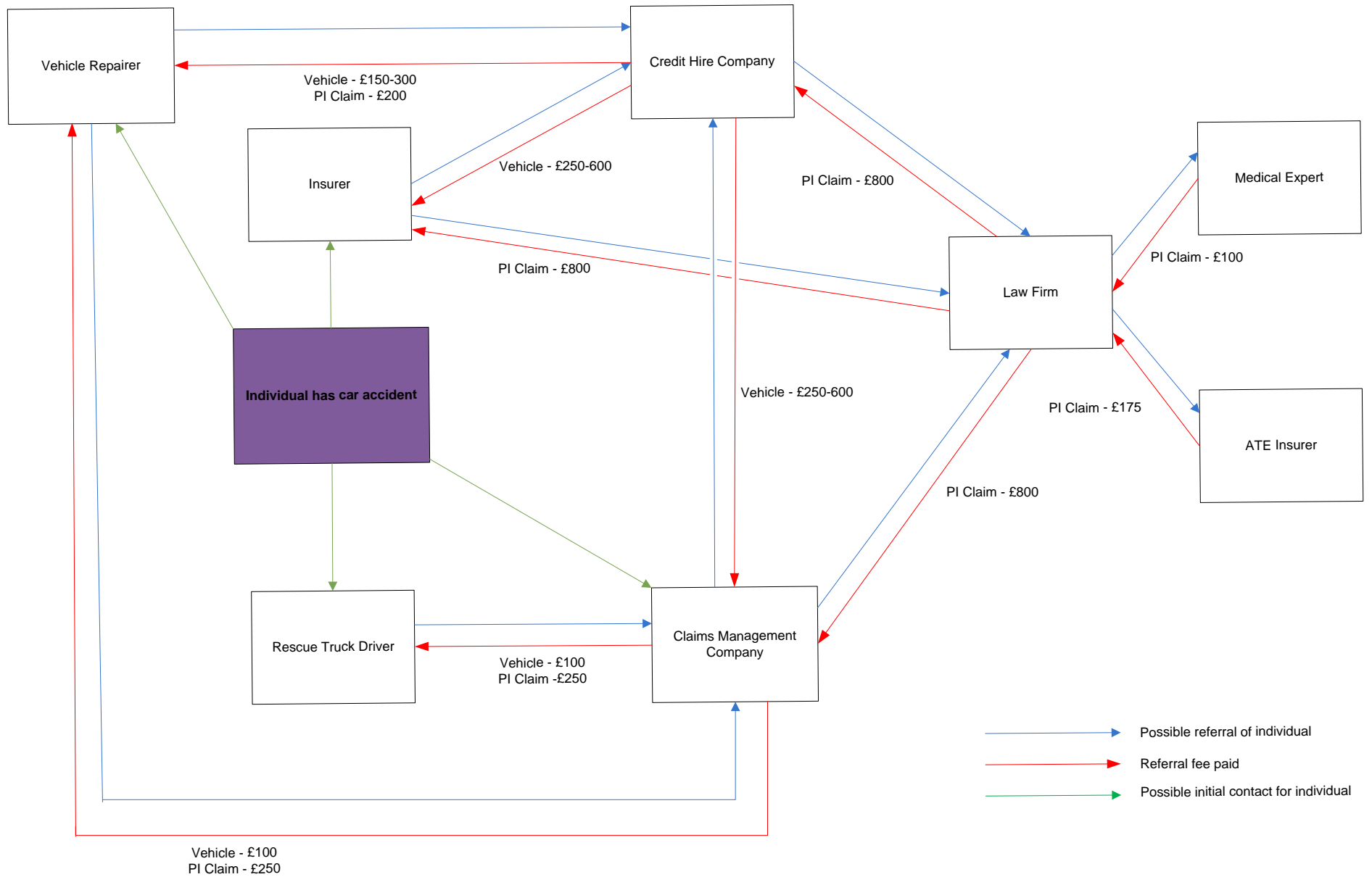
Personal injury

- 3.13. In 2008/09, compensators reported 811,488 personal injury claims, of which 625,072 were motor claims¹⁴. The Ministry of Justice survey suggests that 49% of consumers found their personal injury lawyer via a referral from another organisation¹⁵. The main introducers of personal injury work are claims management companies, before-the-event (BTE) insurers and trade unions.
- 3.14. The consumer's initial point of entry to the legal process will often relate to the circumstances of the injury and can involve a complex chain of referrals. For example,

in a road traffic accident, a taxi driver, car mechanic or recovery truck driver might pass on the person's details to a small claims management company in return for a small fee. If the case looks like it has potential, the small claims management company may refer the case, for another fee, to a larger one, which in turn will pass it, for a fee, to one of the solicitors on its Panel of solicitors. Commissions can occur at various other stages, for example from a medical reporting organisation or a provider of after-the-event (ATE) insurance to the solicitor, or from car hire companies and credit hire agencies to insurers. The potential network of referrals/commissions for a road traffic accident (RTA) claim is illustrated in Figure 1. This diagram also shows how referral fees can accumulate for a single RTA, for example:

- An individual uses a rescue truck driver, who passes their details to a claims management company.
- If the car is damaged, the claims management company passes details onto a credit hire company for an average fee of £425, from which up to £100 would be passed back the rescue truck driver.
- If there is also an injury, the claims management company passes details onto a law firm for a fee of £800, from which up to £250 would be passed onto the rescue truck driver.
- The law firm then passes details onto an After the Event (ATE) insurer for £175 and a medical expert for £100.
- Total money paid in referral fees/commissions: £1500

Figure 1: Potential network of referrals for an RTA claim



3.15. Estimates of the size of referral fees vary and depend on a range of factors including the potential profit for the solicitor, the volume of cases referred and the level of case preparation carried out by the introducer. For example, some claims management companies collect a fee for a “lead” and take no further interest in the case, whereas others act effectively as an agent, obtaining witness statements and handling all the interaction with the client. Evidence to the Jackson report suggests referral fees range between £250-900 with the bulk of fees for fast track claims towards the top of the bracket¹⁶. The Association of British Insurers (ABI) told us that referral fees have risen from £400 five years ago to up to £1,000 now¹⁷.

3.16. SRA data indicates that 42.9% of solicitor firms undertaking personal injury work have referral arrangements¹⁸. Such arrangements have facilitated the emergence of large, specialist personal injury solicitors. In some cases, these firms’ entire business model is based on work referred by introducers.

Claims management companies

3.17. As at March 2010, there were 2,566 regulated claims management businesses¹⁹. This has increased from 1,128 authorised businesses when the regulatory regime began in 2006. Turnover of personal injury claims management companies was estimated at £382 million in 2009, the majority from referral fees²⁰. Seven firms accounted for over one third of this total, with 50 firms accounting for more than two-thirds. This confirms that a small number of large claims management firms dominate the personal injury claims market, with a large number of small firms ‘fighting for the scraps’.

Insurers

3.18. The interests of insurers are two-sided:

- First, liability insurers: when an insured client loses a case, these pay both their own client’s legal costs and those of the successful opponent. Technically, referral fees are not recoverable from the losing party; however, in practice, they are factored into calculations of the solicitor’s base costs.
- Second, BTE insurers: they receive income from referral fees by selling cases generated by clients holding BTE policies to their panel solicitors.

3.19. In 2008, the total UK personal injury claims bill for insurers – including compensation payouts and legal fees - was estimated at £6.7 billion, with motor claims accounting for approximately £3.5 billion of this total²¹. A report by Frontier Economics for the ABI suggests that legal costs account for between 40-50% of total compensation depending on the type of claims; in motor claims, the average legal costs were approximately 43% of total compensation - about £3,000²². Of this sum, solicitors’ base costs, which include marketing costs, accounted for about £2,000.

3.20. The level of income which BTE insurers generate from referral fees is unknown. It is noteworthy that most motor claims are funded by BTE insurance.

Typical referral arrangements

3.21. Referral arrangements can be structured in many different ways. The simplest model is where a lawyer makes a payment to a third-party introducer on a case-by-case basis. However, it is likely that the most common arrangement is where a law firm receives regular work by virtue of being a member of an introducer’s panel of law firms. On receiving a referral, a law firm will

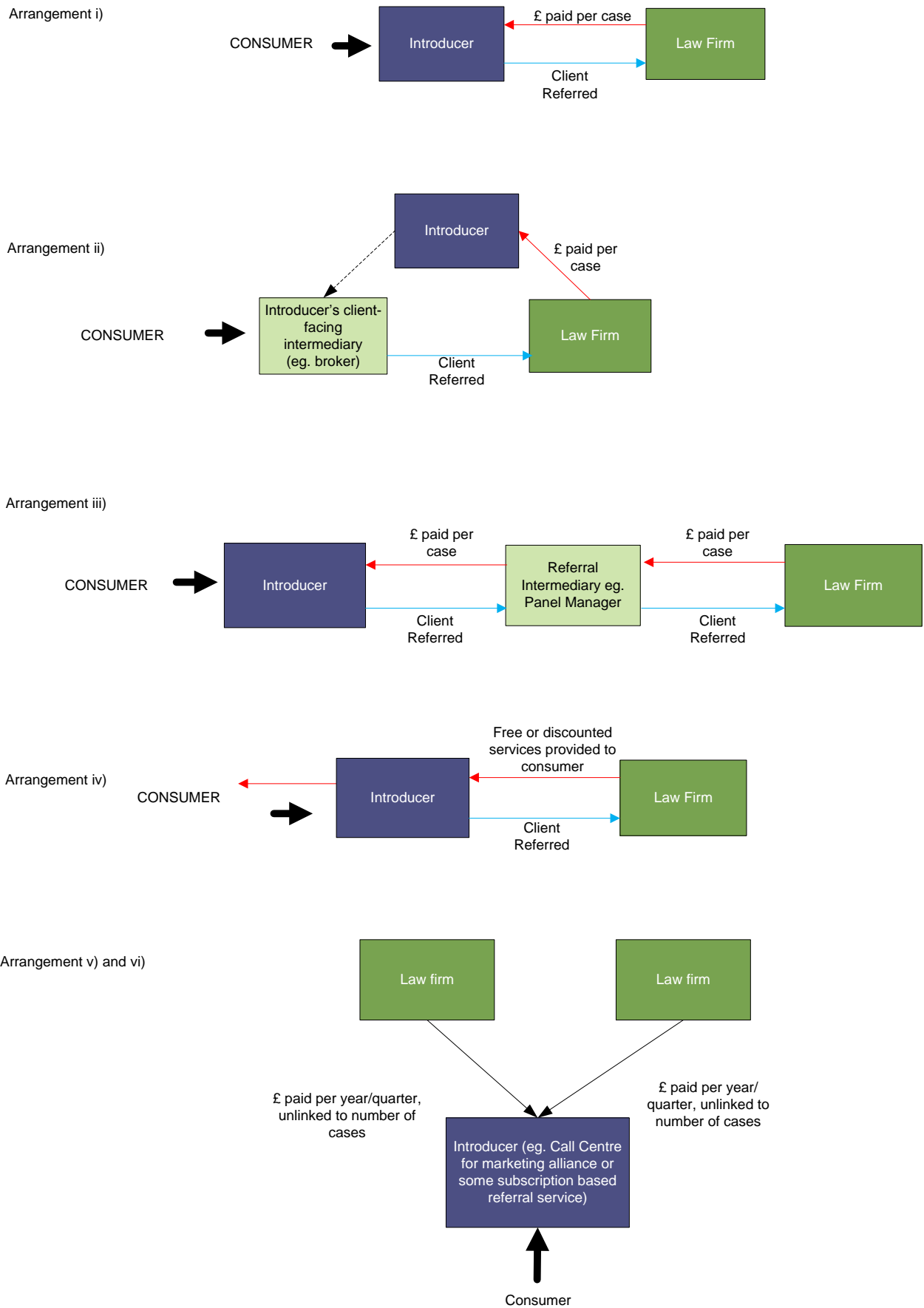
typically review the case and decide whether to accept; if does, the firm will pay the introducer a fee.

3.22. However, referral arrangements come in many forms with differences in payment structures and numbers of intermediaries. The following list describes some of these. Five of the most typical arrangements are illustrated in Figure 2:

1. A law firm, often on an introducer's panel, pays a fee to the introducer for each case that is referred to them.
2. A law firm, often on an introducer's panel, pays a fee to the introducer for each case that is referred to them by the introducer's client-facing intermediary, such as an insurance broker.
3. A law firm pays a fee to a Panel Manager, who acts as an intermediary between a consumer-facing introducer, such as a bank or estate agent, and a panel of law firms. In conveyancing for example, a panel management company would secure conveyancing work from lenders, brokers or estate agents, and then distribute these to the law firms on its Panel. A share of this payment may be paid by the Panel Manager to the original introducer for the initial referral.
4. A law firm will provide discounted or free work for an introducer in one area of law (for example, employment advice) in exchange for the referral of cases in another area of law (for example, personal injury). Similarly, firms may agree to handle minor legal work (for example, car accidents where there is no injury) in return for receiving more lucrative personal injury claims from insurers.

5. A law firm will pay periodic subscription or membership payments to be part of a legal services referral or matching website.
 6. A law firm will pay a share of the costs for a marketing alliance, with clients allocated to members on an agreed distribution basis, such as a rota or geographical proximity.
 7. A law firm pays an annual membership to have access to a specific insurance product, the provider of which will refer clients for free.
- 3.23. For many of the above arrangements, especially where the introducers are large, such as major claims management companies, insurers or estate agency chains, the law firms involved are selected to be on the introducer's panel and there will be a vetting process and formal referral agreements in place. Often, Service Level Agreements will set out a guaranteed "customer offer" in respect to things such as use of technology, service standards and fee scales.
- 3.24. Where annual panel membership or organisation subscription fees are paid, discussions with stakeholders and the information presented on membership websites indicates that the cost tends to be calculated on a firm-by-firm basis, depending on: the size of the firm, the number of cases referred each period, area/s of expertise; and exclusivity of referrals for a specific geographical or practice area. Alternatively, solicitors may pay the introducer a percentage of their fees on cases referred to them.
- 3.25. Where there are intermediaries between the original source of the referral and the lawyer, the referral fee will not always be paid to the party that is making the referral. This presents challenges in terms of enforcing transparency rules.

FIGURE 2: Types of Referral Arrangements



Trade unions

- 3.26. Trade unions are not for profit membership organisations. They instruct solicitors to provide advice to their members and provide representation for certain claims. Usdaw, the Union of Shop, Distributive and Allied Workers, informed us that approximately 1 in 27 members seek legal assistance annually²³.
- 3.27. Trade unions tend not to charge lawyers a referral fee, but instead receive certain free or reduced cost legal services for their members. These services might include telephone help-lines, wills or training for union officers on employment law.
- 3.28. In research on employment tribunals, it was reported that a fairly common practice is for solicitors to discount rates charged for employment cases referred by trade unions on the understanding that the firm will be referred personal injury cases²⁴.

Regulatory requirements

- 3.29. The regulation of referral arrangements should be examined from both the lawyer and introducer ends for their impact on consumers. This is a complex exercise as there are a number of legal regulators and many introducers. A further complication is not all legal services providers in referral arrangements are regulated, for example will-writers. The disparate nature of the regulatory framework has meant that the rules around referral arrangements are inconsistent across the market and their enforcement is subject to the different priorities of each regulator. A summary of the regulatory requirements for lawyers and introducers is provided in Annex 3.
- 3.30. Only barristers and immigration advisers are expressly prohibited from entering into arrangements involving referral fees, while the Legal Services Commission also does not allow the practice. Where referral fees are permitted, the main rule is that professionals must not enter into arrangements that will impinge on their independence or their ability to work in the best interests of the client. Key rules relate to client disclosure, the stringency of which varies between regulators.
- 3.31. Transparency to clients is also a major focus of the rules for introducers, although estate agents only have such obligations to sellers. Furthermore, claims management companies, although regulated, face a less onerous disclosure regime, especially to consumers with no contractual relationships with the claims management firm. Trade unions are exempt from the need to be authorised under the Compensation Act 2006 in respect of services provided to their own members (or retired members), although this is conditional on their acting in accordance with a code of conduct, which includes disclosure requirements.
- 3.32. An important difference between the regulation of solicitors and other legal professionals is that solicitors are expected to police introducer compliance with the solicitors' rules. For instance, solicitors are responsible for ensuring that estate agents comply with the SRA's disclosure rules. This has the potential to create regulatory conflict, for example the solicitors' rule require estate agents to disclose referral fees to buyers even though this is not required by their own regulations.
- 3.33. In addition to sectoral regulatory requirements, law firms and introducers must comply with general consumer law, including the Consumer Protection from Unfair Trading Regulations 2008 (CPRs). The CPRs prohibit certain unfair commercial practices including misleading omissions. A misleading omission includes failing to give consumers the information they need to make an informed choice. According to Guidance²⁵, this occurs when practices "omit or hide material information, or provide it an unclear,

unintelligible, ambiguous or untimely manner, and the average consumer takes, or is likely to take a different decision as a result". The CPRs also prohibit a business from providing false information on the motives for a commercial practice, and ban aggressive sales practices.

- 3.34. While these regulations are still relatively new, and yet to be tested in court, they could apply to referral arrangements, such as: an introducer claiming that a recommendation was being made on the basis of quality, when it was actually based on a financial arrangement; an introducer or a law firm omitting to tell a consumer that a referral fee had been paid or received, or providing such information in an unfair way; an introducer pressurising a consumer to use a recommended lawyer.

Summary of key points

- Referral arrangements are common in the legal services market: a large number of consumers, whether by passive or active choice, find a lawyer via a referral from another organisation, and a substantial proportion of solicitors, especially larger firms, enter into referral arrangements.
- Solicitors are referred work by a diverse range of introducers, including trade unions, charities, other not-for-profit groups, or commercial operators.
- A personal injury claim or a house sale can involve a complex chain of referrals with commissions earned by various parties at different stages.
- There is a wide range of referral arrangements, involving different payment structures and the potential for multiple actors.
- Referral arrangements are subject to multiple regulatory regimes. The rules applied by each legal regulator vary, in particular around the role of professionals in policing introducers and disclosure. Introducers are separately regulated, and in some cases are largely unregulated, while different rules apply to different types of introducer

4 Independence

Introduction

- 4.1. Acting independently and in the best interests of clients rightly lies at the heart of lawyers' core duties across the profession. Consumers generally lack the expertise to assess whether legal advice is compromised by the relationship between lawyers and introducers of work. Instead, consumers must rely on regulators to prevent relationships from developing that work against their interests.
- 4.2. The permissibility of referral arrangements hangs on the issues covered in this section. Referral arrangements should be prohibited where they compromise the ability of lawyers to fulfil their overarching responsibility to act in the best interests of clients. This consideration is fundamental and overrides other possible benefits of referral arrangements, including improved access to justice. There would seem little point in promoting access to justice which works against the interests of consumers.
- 4.3. This section of the report considers:
 - Whether referral arrangements carry theoretical risks to the independence of lawyers; and
 - Evidence of consumer detriment

Risks to consumers

- 4.4. The Bar Council's submission epitomises the danger seen by many lawyers:

"It is difficult to see how the payment by a solicitor of a referral fee to secure him instructions is compatible with his duty to act independently in his client's best interests and not to act in a manner that is

likely to diminish public confidence in his profession."²⁶

- 4.5. The risk that lawyers will act against their core duties is greatest when three conditions are present:
 - Unequal power relations: the introducer can influence the behaviour of lawyers by virtue of an unequal power relationship between the introducer and the lawyer;
 - Freedom of choice is constrained: consumers are forced or put under pressure to use a lawyer nominated by the introducer; and
 - Misaligned incentives: the interests of introducers are not aligned with those of consumers.
- 4.6. There would appear to be little risk to consumers when their interests are aligned with introducers. Even where an introducer was in a position to influence a lawyer's actions, this may not cause detriment if the introducer's interests were identical to those of the consumer. Equally, where the interests of the introducer and consumer conflict, this should not cause a problem if the lawyer is unfettered in acting on behalf of the client.

Unequal power relations

- 4.7. The presence of either of two factors could result in unequal power relations between introducers and lawyers, enabling introducers to exert undue influence over a lawyer's actions. First, if lawyers are too reliant on an introducer for work, they may be reluctant to take action that would harm the introducer's interests. Second, if an

introducer can dictate the service provided to clients through the terms of the contract with the lawyer underpinning the referral.

Reliance on introducers for work

- 4.8. SRA data indicates that 19% of firms enter into referral arrangements with this figure rising to 52% of firms practising conveyancing and 43% of those practising personal injury²⁷. Therefore, half such firms operate without referral arrangements, and, across the whole field, business still comes to firms mostly directly from consumers via personal recommendation or searching the market.
- 4.9. The SRA collects data on the amount of turnover that work from referrals represents to solicitor firms. Table 3 shows that referral fees represent a relatively small proportion of turnover for the vast majority of businesses. However, surveys of law firms suggest that volume firms often base their business models on referral arrangements. For example, an

Association of Personal Injury Lawyers (APIL) survey reported 27% of member firms were “heavily reliant” on payment of referral fees with over 80% of work coming through this route²⁸.

- 4.10. A business model largely based on referrals from introducers does not by itself undermine independence. Rather, it is the amount of work coming from a single source that can create the dependency and thus the opportunity for improper influence. Table 4 reveals that sole practitioners and firms with 2-4 partners are the most likely to obtain work from just one introducer. SRA data also suggests that sole practitioners and firms with 2-4 partners are the most likely to obtain more than 50% of their income from referral fees from one or two sources. However, across the whole market, this is true for just 1% of sole practitioners and 1.4% of 2-4 partner firms. Therefore, the risk of over-reliance appears to be confined to a tiny proportion of law firms.

Table 3 – Referral fees as a percentage of income

Income Range	No. of Law Practices	as % of Law Practices
0.1 - 10%	868	56%
11 - 20%	202	13%
21 - 30%	128	8%
31 - 40%	81	5%
41 - 50%	56	4%
51 - 60%	29	2%
61 - 70%	25	2%
71 - 80%	31	2%
81 - 90%	28	2%
91 - 100%	91	6%
Total	1539	

Source: SRA

Table 4 – Average numbers of introducers

Law Practice Size	No. of Introducers		
	Mean	Mode	Median
Sole Practitioner	3	1	2
2-4 Partners	5	1	2
5-10 Partners	8	1	3
11-25 Partners	10	1	4
26-80 Partners	11	1	4
81+ Partners	5	1	2
All Law Practices	6	1	2

Source: SRA

4.11. This is confirmed by regulatory activity. A review of Solicitor Disciplinary Tribunal decisions reveals examples where an over-dependency on a single introducer was created. In some cases, the referral arrangement was a fig leaf disguising the fact that the law firm and introducer were to all intents and purposes the same entity. In 2007, the then chair of the SRA wrote:

*“In several cases it was clear that the solicitors had put the interests of the introducer above their clients’ interests, often because they were over-reliant on the introducer as a source of work”.*²⁹

4.12. However, these cases represent the worst abuses and are not typical of the general market situation. Since the miners’ compensation cases, the SRA has mounted an intensive education and inspection regime. Inspections by the Practising Standards Unit continue to uncover high levels of non compliance with the detailed referral fee rules, but breaches of Rule 1 of the Conduct of Conduct – covering the core duties - are very few³⁰.

Ability to dictate the terms of agreement

- 4.13. An agreement in writing is mandatory for solicitors involved in financial referral arrangements. The content of such agreements are likely to offer useful clues as to whether the introducer could unduly influence the lawyer’s behaviour.
- 4.14. The SRA has commented that, *“in the case of most of the large referral schemes, which involve a number of firms, the agreement is drawn up by the introducers, or their legal representatives, and the terms, which are not normally negotiable, are often more favourable to the introducer than the solicitor”*³¹.
- 4.15. An imbalance of power is unsurprising as traditional law firms are small and fragmented, while introducers include large national brands, insurers and trade unions.
- 4.16. One-sided agreements need not always harm consumers. For example, introducers can include conditions that benefit consumers such as extended opening hours or ‘no sale, no fee’ agreements. However, the Panel has heard anecdotes of more negative clauses, such as introducers requiring confidential information from law firms or dictating

which ancillary service providers must be used (such as medical experts).

- 4.17. One conveyancing firm, Brethertons LLP, highlighted how relationships with introducers that were initially sustainable can become unviable once referral contracts come up for renegotiation.

“The firms that pay referral fees to an estate agent or third party find themselves squeezed on profit margins. The referrer will control the pricing structure of the conveyancer, either by expressly setting the rates to be charged by the conveyancer, or by restricting the volume of work referred according to the prices charged, which effectively amounts to the same thing. The referral fee then becomes disproportionate to the price. The conveyancer is then reliant on the volume provided by the referrer to fund the staff needed. Referral contracts that looked viable the first year become subject to penal terms imposed by the referrer on renegotiation for the following year.”³²

- 4.18. Once a lawyer has chosen to acquire work via an introducer and is receiving a steady flow of work, withdrawing from that relationship can be potentially risky. Such a risk is mitigated if there is competition between introducers to attract lawyers. However, as discussed in the chapter on competition, there is more competition between lawyers to get onto panels than between introducers to attract lawyers.
- 4.19. Therefore, the dynamics of referral arrangements allow introducers to dictate the terms, but the key factors are the nature of the terms and whether lawyers can afford to withdraw from the relationship.

The introducer's stake in the outcome

- 4.20. There would seem to be greater potential for conflict should the introducer have a commercial or other interest in the outcome of the legal work. Where claims

management companies receive their fee once the lead is passed to the solicitor and take no further interest in the claims, they will have no reason to influence the lawyer's actions. Similar dynamics exist in solicitor collectives where work is allocated via a rota and without any further involvement of the introducer. By contrast, as estate agents typically receive commissions from multiple ancillary providers only once a sale has completed, there is a theoretical risk that they could put pressure on a conveyancer to ensure no problems are highlighted.

- 4.21. Other risks arise when introducers do not have an incentive in the outcome of the legal work, as the introducer has a weaker incentive to ensure that work is referred to a high quality provider.

Freedom of choice

- 4.22. The ultimate safeguard against conflict of interest is that the consumer is free to choose their own lawyer and not accept the referral. However, consumers are poorly placed to assess whether a recommended lawyer is a good one. Where introducers have a vested interest in a particular lawyer, they may exert pressure on consumers to accept their recommendation.

Referrals to the highest bidder

- 4.23. The most common concern about referral arrangements is that introducers pressurise clients to use the lawyer who pays the highest referral fee, not the lawyer who would be best for the client. This accusation is levelled in both conveyancing and personal injury. Both APIL³³ and The Institute of Legal Executives (ILEX)³⁴ stated that insurers refer personal injury work to the highest bidder through closed bids. A respondent to an ILEX member survey reported:

“some buyers or sellers in property transactions are now effectively sold by estate agents to the highest bidder (that is whoever will pay the highest referral fee) without any thought of which firm would offer the best service, value for money”³⁵.

4.24. Examples of bias this might lead to include:

- towards higher cost services – especially where the lawyer passes the cost of the referral fee back to the consumer in charges;
- towards unsuitable service providers, where the introducer recommends a lawyer without sufficient expertise to deal with complex cases; and
- towards recommending work that might not be necessary or could be carried out by a non professional.

4.25. It is important to unpick what “best for the client” means. This goes beyond the content of advice to quality of service and value for money. For example, if an introducer recommends the most expensive legal provider because this yields the highest referral fee, this is not in the client’s best interests, especially where there may be a range of providers who are suitable to meet the consumer’s needs.

4.26. Commission bias has been at the heart of misselling in financial services. Indeed, the Financial Services Authority (FSA) has recently acted to end commission payments for investment products (see box).³⁶ Legal services are similar to financial services in that consumers lack the expertise to judge quality and value for money by themselves, but tend to trust the professional advising them.

Tie-ins

4.27. There are arrangements where introducers require lawyers to use specific providers for non-legal aspects of work which are referred to another professional, such as a medical expert in a personal injury case. These providers then pay a commission to the original introducer. Alternatively, some lawyers have similar arrangements with ancillary providers in return for a commission. This creates the same concerns around poor selection of provider as described above. In addition to issues around cost and suitability, the practice denies consumers choice and dampens competition. The SRA permits solicitors to refer to preferred suppliers, but a binding agreement to use that supplier is not allowed. However, there is anecdotal evidence that such practices still happen.

FSA decisions on Commission Payments

The FSA has introduced a system of ‘Adviser Charging’, which will involve all firms that give investment advice to retail clients setting their own charges. Once the rules come into effect, adviser firms will no longer be able to receive commissions set by product providers in return for recommending their products, but will have to operate their own charging tariffs in accordance with the new rules. Should they wish to do so, providers will be able to facilitate the collection of adviser charges through the product on a matched basis. The FSA has also made some changes to its rules and guidance on inducements, to reflect the introduction of Adviser Charging and ensure that it cannot be circumvented by firms being paid through ‘soft commissions’.

“Pressure selling” in conveyancing

- 4.28. The OFT identified a risk that the prospect of earning referral fees might lead estate agents to put pressure on the consumer to use a recommended conveyancer, by overstating how much better the chances of the transaction proceeding smoothly are with professionals they know³⁷. Similarly, the Panel sees that conveyancers might put pressure clients to use recommended services from which they get a commission, such as a surveyor or Home Information Pack (HIP) provider.
- 4.29. Evidence collected by the OFT suggests that estate agents routinely attempt to cross-sell the services of partner solicitors. Some consumers complained that they were put under undue pressure to purchase ancillary services from the estate agent’s business partners: 29% of those using a recommended conveyancer felt some degree of pressure to take the recommendation. In respect of the full range of ancillary services, the OFT found that 82% of buyers did not feel that they had received a ‘hard sell’ from their estate agent. One in ten buyers reported that the “estate agent tried very hard to persuade me” to use the recommended conveyancer – while a minority, this is not an insubstantial figure. However, the OFT’s research also indicates that many consumers reject the estate agent’s recommendation: 51% of sellers were recommended a conveyancer, but only 29% used this provider; the figures for buyers were 44% and 20% respectively³⁸.
- 4.30. Our consumer focus groups reported similar results. One participant commented: “*It seems to be the first question an estate agent asks... have you got a solicitor?*” There were isolated cases of estate agents getting “shirty” with clients when they chose to use their own conveyancer, but this was not the norm. Instead, the majority of consumers said

they felt confident in rejecting any pressure exerted by estate agents. However, this is not helped by low levels of compliance with transparency rules. In a survey of estate agents conducted by the OFT, only 53% of estate agents that received referral fees from conveyancers informed their customers of the size of the fee. A further 28% told their customers about the existence of the fee, but not the amount³⁹.

Personal injury

- 4.31. When someone has an accident, the prospect of getting a finder’s fee means there is a race among potential introducers to pass the client’s details to a lawyer. This can benefit consumers as they are put in touch with advice quickly and inconvenience is minimised (for example in a road traffic accident a replacement car is despatched immediately). At the same time, however, the consumer is at their most vulnerable after suffering an injury and more susceptible to influence, which might mean they do not end up with the most suitable lawyer.
- 4.32. In the course of the interviews with personal injury claimants, there were some cases where claimants had made choices relatively soon after an accident, as a result had gone with a ‘referred’ solicitor, but with hindsight felt that they might have researched the decision a little more if given time:

“I think my case (referred through her insurance company) probably involved backhanders... I know some people who’ve had a bad experience with that – I prefer word of mouth. If it happened now I’d go by word of mouth, but at the time I was very vulnerable, traumatised physically so I just went with it.”

35-54, ABC1, personal injury in-depth interview

Denial of choice – legal expenses insurance

- 4.33. Where consumers make a claim funded by legal expenses insurance, insurers will recommend a panel solicitor. As the insurer pays the legal fees, there is an obvious incentive for them to keep costs to a minimum, by appointing the cheapest lawyers or limiting the time that lawyers work on a case.
- 4.34. Freedom of choice of solicitor in cases funded by legal expenses insurance has been considered by the courts⁴⁰ and the Financial Ombudsman Service (FOS)⁴¹. The legal position seems to be that consumers only have freedom to appoint their own solicitor once court proceedings are formally issued, before this an insurer is not required to offer a policyholder a choice of solicitor. The FOS has suggested that in more complex cases, or those with special features, good industry practice would be for the insurer to accept the client's chosen solicitor.
- 4.35. The policy issues this raises are beyond the scope of this report. However, the income that an insurer will receive from referral fees provides an additional incentive for them to encourage consumers to use a panel solicitor. APIL argues that this has meant that injured people are put under considerable pressure to use a panel firm even when it may not be in their best interests and not the solicitor of their choice⁴². APIL provided us with anonymised copies of letters that have been sent to injured people by their insurers, which include phrases that appear to discourage policyholders from choosing their own solicitor. For example:

“Given that we have favourable agreements with our panel firms with regards to the rates they charge, your indemnity limit could, potentially, provide cover for more work than if a non panel

solicitor is instructed, thereby reducing the chance that you will become personally liable for any costs. If you continue to instruct your own solicitors, you will need to cover these costs on a private basis until such time as proceedings are issued.

“In the event that proceedings do become necessary we will be happy to consider the appointment of your nominated solicitor in accordance with your right to freedom of choice. However, the Financial Services Authority (our regulating body) requires that we satisfy ourselves that the firm you have selected has the necessary expertise and infrastructure to deal with your claim. This will inevitably delay the progression of your claim.”⁴³

- 4.36. The Consumer Panel will return to issues around freedom of choice of solicitor.

Misaligned incentives

- 4.37. This section discusses the circumstances where the interests of introducers and lawyers are not aligned with those of consumers, and examines whether there is any evidence that this leads to conflicts of interest. This relates to examples of deliberate bias; issues about the quality of advice are examined in the section on competition.

Estate agency

- 4.38. Being the focal point of property transactions for sellers and buyers, estate agents are well positioned to act as introducers to other related services. They introduce sellers to HIP providers and conveyancers, while buyers are introduced to financial services providers, surveyors and conveyancers.
- 4.39. The OFT examined risks to sellers of conflict of interests in its study into home buying and selling (see box)⁴⁴. The Consumer Panel's remit covers consumers of legal services. While sellers use legal

services, they are not at risk of biased legal advice. This discussion focuses on risks of biased legal advice to buyers.

Buyers

- 4.40. The interests of estate agents and buyers are aligned in that it is the interests of both for the sale to go ahead. The estate agent receives commissions from the seller and any ancillary services introduced by them only once the sale has been completed. However, it is not always in the interests of buyers to proceed with a sale, for example

where planning enquiries reveal a new housing estate is to be built on empty land nearby. The risk is that a conveyancer will turn a blind eye to problems, such as a defect in the title or a planning issue, which might cause a house sale to fall through and deny the estate agent their sale and other commissions. As infrequent purchasers, buyers may not realise such conflicts exist let alone spot them; indeed, participants in our focus groups struggled to see where the estate agent's interests could be different to the client's.

OFT Analysis in relation to sellers

The role of an estate agent is to act on behalf of the seller, so the interests of estate agent, seller and conveyancer would appear to be aligned. However, the OFT suggests it might be financially advantageous for estate agents to prefer buyers making lower offers if the sale commission on the property plus fees paid by mortgage lenders and other introducers exceeded the sale commission on a higher offer price. Faced with these incentives, the estate agent might not act in the seller's best interests, for example by failing to pass on a higher offer or by trying to convince the seller to accept a lower offer perhaps by promoting this as a safer prospect in terms of the likely completion.

The OFT's report gave the following hypothetical example

	Competing Buyers	
	Buyer 1	Buyer 2
Offer	£160,000	£175,000
Commission rate	1.60%	1.60%
Fee for Selling House	£2,560	£2,800
Fee for mortgage introduction	£350	
Potential income	£2,910	£2,800

The OFT concluded: "The evidence therefore suggests that there is more than a theoretical risk of a conflict arising and that the fees being earned by estate agents from referring buyers to other services could be adversely impacting on the impartiality of the advice being provided to sellers".

- 4.41. We have not found any evidence to support the theory that conveyancers deliberately fail to alert buyers to issues. A couple of responses to our call for evidence by practitioners pointed to the risk, but did not provide evidence that it happens in practice. In consumer research for the OFT, 25% of sellers had experienced a sale falling through after they had accepted an offer on a home, but problems highlighted by conveyancers were not among the reasons given for the non completion⁴⁵.
- 4.42. In mitigation of this risk, there is a strong likelihood that a problem causing consumer detriment would be discovered when the property is resold. The penalties that could follow – a redress award by the Legal Ombudsman or disciplinary action – should have a deterrence effect.
- 4.43. Unlike other introducers, estate agents are largely unregulated (although they must belong to an approved redress scheme and are subject to specific rules and a negative licensing regime enforced by the OFT). This is problematic as estate agents do not have the same duty of care to their clients as conveyancers have.

Personal injury

- 4.44. A brief description of the funding of personal injury claims is provided in Annex 4. Key features are:
- consumers typically do not pay their own legal fees
 - lawyers only recover their costs (plus a success fee) when they win
 - lawyers' recoverable costs are fixed for certain types of claim
- 4.45. Based on responses to our call for evidence and an analysis of the market, there are specific areas where there is at least a theoretical conflict between the interests of clients and introducers.

Under-settlement

- 4.46. Industry practitioners suggest that law firms can adopt one of two approaches to maximise revenue from personal injury claims. In the first model, firms process high volumes of claims and turn them around as quickly as possible. In the second, firms explore every avenue to prolong the claims process in order to obtain higher fees. In fixed costs regimes, claimant lawyers can drag out a case so that it is exempted from the fixed costs procedure, and therefore recover higher legal costs based on hours worked.
- 4.47. Opponents of referral fees claim that these incentivise lawyers to encourage claimants to accept a lower offer of compensation than they could reasonably expect. Firstly, because referral fees eat into solicitors' profits producing an incentive to minimise effort. Secondly, because there is an incentive for solicitors to turn cases over quickly to protect their cash flow. Whereas lawyers typically pay the referral fee immediately following introduction, they will not receive payment of legal costs or their success fee until the claim has settled – which could take years if the case goes to trial. The claimant could be particularly disadvantaged if further effort or time, for example obtaining a medical report, would have increased the size of damages awarded. As one lawyer interviewed by the Moulton Hall study said:
- “Cash flow becomes critical so solicitors want to turn the cases over quickly to protect their cash flow, so some claims look small in the beginning and the client doesn't recover as quickly as predicted, after waiting a year for a medical report and then another year, the claim could have risen from £2k to a £100k claim after several years. There are some cases like that. We had one like that and we got £240k for her, some firms would have settled for £3k early on. In a PI claim 9/10*

will recover in 6 months, 1/10 are sold down the river.”⁴⁶

- 4.48. The consumer is free to accept or reject the lawyer’s advice on a settlement offer. However, research in employment tribunal cases suggests that clients are deferential towards lawyers and do not challenge advice⁴⁷. The same report highlighted how Damages Based Contingency Fee practitioners and third party funders (such as legal expenses insurers and trade unions) often maintain control over settlement decisions via clauses allowing them to impose negative consequences on clients who reject advice, such as withdrawal of funding. Should lawyers become over-reliant on third parties for work, there is a risk they might encourage clients to accept a low settlement offer.

Road traffic accident (RTA) claims

- 4.49. Under-settlement would appear to be a greater risk in fixed-fee regimes as lawyers are not rewarded for putting more effort into a claim. The Accident Compensation

Solicitors Group, in warning of a legal challenge in relation to the new fixed costs regime in RTA cases, has said it has evidence that claims are being under-settled in areas where costs have not been increased since the old scheme was introduced in October 2003⁴⁸. However, it is the fixed fee regime, rather than the referral fee, which produces an incentive for lawyers to minimise effort. The referral fee may compound the issue as it eats further into the solicitor’s profit, but it is not the root of the problem, which should be tackled by ensuring that the level of fixed recoverable costs is fair.

- 4.50. Data on average claims payments in motor bodily injury cases make it difficult to sustain the argument that referral fees have caused under-settlement in RTA cases (see Table 5). Amounts have fluctuated since 2001, but over the period rose by 7.4%⁴⁹.

Table 5 – Claims payouts in motor injury cases 2001-2008

Year	Number notified	Average claims payment amount (£)	Yearly change in average payment (%)
2001	127,793	2,556	
2002	116,638	2,881	12.7%
2003	116,412	2,505	-13.1%
2004	129,188	2,227	-11.1%
2005	158,644	2,818	26.5%
2006	183,409	2,659	-5.6%
2007	204,130	3,022	13.7%
2008	210,906	3,512	16.2%

Source: Datamonitor

4.51. In many RTA cases, liability will be straightforward to establish and the level of damages easily worked out using guidelines and software tools. The opportunity for under-settlement is greatly reduced when the compensation regime is predictable. Outside of these standard cases, as the SRA points out, it is extremely difficult to assess whether a solicitor is routinely under-settling cases referred by a particular introducer as so many factors will affect the sum recovered and the decision whether or not to issue proceedings⁵⁰. In particular, the precise amount of damages will vary according to the duration and severity of the injury, and its impact on the person's lifestyle.

Cherry-picking cases

4.52. In a fixed-fee regime, lawyers may decide not to take on complex or borderline cases if, after the referral fee is factored in, the level of effort required means they will make minimal profit or even a loss. Such cases are important not only to compensate the injured, but to test law and set precedent that might benefit future claimants. The Legal Services Commission warned us that allowing referral fees in legally aided work could result in an increase in cherry picking, with more difficult cases or clients referred on by providers when they themselves could handle the case⁵¹.

4.53. Again, however, the root of the problem is the fixed-fee, although referral fees might compound the issue as the solicitor is giving away part of their income to the introducer. While referral fees might distort the risk equation and lead lawyers to conclude that pursuing the claim is not worth the effort, the solution is to ensure that appropriate referral fees are factored into the solicitor's recoverable costs, not to ban referral fees.

4.54. Claims data does not support the argument that cases are being routinely

rejected. Volumes of RTA claims have remained stable despite the rise in referral fees, and in the last couple of years have risen sharply. Lawyers will have an incentive to pursue claims provided they can make a reasonable profit. As it is in the interest of introducers for lawyers to take on cases, market forces would suggest that the fixed-fee regime maintains referral fees at a level that lawyers can afford to pay. In reality insurers accept liability in the vast majority of RTA cases⁵², which favours the claimant lawyer. Finally, the Panel did not receive any hard evidence that lawyers are refusing to accept cases nor are there media reports that claimants are being denied access to justice.

Summary of key points

- SRA data suggests solicitors are not over-reliant on work coming from a single introducer – which is the key risk creating the opportunity for introducers to exert improper influence. The SRA has identified individual cases and intervened accordingly, but very few of its inspections uncovered breaches of independence rules.
- There is more compelling evidence that introducers can control the terms of agreements, which can either advantage or disadvantage consumers. Arrangements that seem viable for lawyers one year might become unsustainable once the agreements are renegotiated.
- A major concern is where introducers refer work to lawyers paying the highest referral fee, not to the lawyer that is best for the client. This could mean introducers recommending high cost or unsuitable lawyers, or towards recommending work that could be carried out by a non professional.
- There is evidence of introducers putting pressure on clients to go with their recommended panel solicitor. While many consumers reject recommendations, people in a vulnerable position will be more susceptible to such pressure.
- There are risks where the incentives of introducers and consumers are not aligned. However, the evidence does not substantiate these concerns. Moreover, in the personal injury market, referral arrangements reflect or exacerbate deeper market problems. Any such market imperfections should be remedied at source.

5 Access to Justice

Introduction

5.1. Improving access to justice is one of eight regulatory objectives in the Legal Services Act. The Act does not define access to justice and there is much debate over what it means in the context of legal services regulation. In the context of referral arrangements, there are two dimensions of access to justice:

- Whether introducers improve the likelihood of consumers identifying when they have a legal need and of finding a suitable provider to meet that need. Alternatively, whether in the absence of an introducer, consumers would easily locate legal advice through other means.
- Whether introducers help consumers to navigate their way through the justice system more effectively.

5.2. Introducers make a greater contribution towards improving access to justice in some areas of legal work compared to others. Conveyancing and divorce are two examples where using a lawyer is almost obligatory and thus consumers would locate one in the absence of introducers, although possibly less efficiently. By contrast, in areas such as will-writing and personal injury, people might not be aware that lawyers could assist them, so advertising or the suggestion of action by an introducer could be a helpful prompt. This section focuses on the second of these categories – where consumers may not think to approach a lawyer.

5.3. Many factors impact on the consumer's ability to access justice, with referral arrangements having a relatively minor

impact compared to the cost of legal services. Thus, the availability of 'no win no fee' agreements is likely to make a bigger difference to the ability of consumers to pursue personal injury claims than the marketing by claims management companies.

To what extent do consumers access legal services?

- 5.4. The English and Welsh Civil Justice Survey⁵³ is a major longitudinal survey detailing people's experiences of problems involving their rights and the strategies they use to resolve them. It reveals a picture of significant unmet legal need as many consumers are unsure where to get help to resolve their problem. It also shows consumers' ability to access justice greatly depends on how effectively they are connected to legal advice.
- 5.5. 36% of people experience legal problems in any one year, with those more vulnerable to social exclusion reporting more problems than others. Almost half of respondents obtain advice, but 8.8% do nothing to resolve their problem. Those who obtained advice, and those who handled their problems alone, were more likely to reach a resolution for their problem. This contrasted markedly with problems where respondents tried but failed to get advice, where the vast majority simply gave up or did nothing.
- 5.6. The role of the advice sector (such as charities, citizen advice bureaux, law centres) in connecting consumers to legal advice, alongside that of commercial introducers, is important. A key difference is that introducers meet consumers in the

context of other commercial transactions or proactively reach them through their marketing. By contrast, consumers who use an advice sector route will typically have to find an adviser before then being connected to a lawyer, presenting an additional hurdle to overcome.

- 5.7. Many consumers who would benefit from legal advice do not get it, while others give up before their problem is resolved. A key question is the extent to which commercial introducers help to close this gap.

The impact of introducer marketing

- 5.8. The main focus of this section is personal injury, where the contribution of introducers in improving access to justice is most fiercely debated. Introducers claim to 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. Even some opponents of referral fees acknowledge that marketing by claims management companies has brought more people into the justice system. However, they argue that people now know they can make a claim and so would be able to find their way to a lawyer anyway, while the marketing of claims management companies has bred an unhealthy compensation culture which dissuades some people from making genuine claims.

Evidence from the Consumer Panel's consumer research

- 5.9. A key objective of the qualitative consumer research was to explore the value that consumers place on the marketing undertaken by claims management companies, and the impact this activity has on access to justice for different types of consumers.
- 5.10. Outside of personal injury, most of the consumers in the research did not respond to advertising by law firms. Personal injury

claimants reported a different perspective, however. A number behaved similarly to the wider consumer group: they were intent on initiating a case, asked around for recommendations and proactively approached their chosen solicitors. Many though did make some use of marketing, either in persuading them to initiate cases or helping them choose a suitable firm.

5.11. Examples included:

- A young woman, who had spoken to a number of solicitors directly but had not found any she was comfortable with, then responded to a TV advert for a claims management company and felt it walked her through the process very soothingly.
- A young woman who had suffered pains as a result of a car accident and who was approached directly by her insurance company asking if she was interested in making a claim – without their approach she may not have considered initiating a claim.
- A middle-aged man who suffered whiplash injuries in a car accident, heard an advert on the radio for solicitors specialising in personal injury, and as he was not aware of firms in the North East went to them directly.

5.12. The first example suggests that claims management companies have flourished because many solicitors have poor client care skills which people find off-putting, even to the extent that they may not pursue their case.

5.13. At the same time, there was also a sense that most consumers now know that personal injury claims are an option. Those with the most serious injuries (for instance broken bones, hospital stays or head injuries) were mostly already intent on making a claim; any marketing activities just helped them choose a firm. In comparison, marketing helped those with

less severe injuries (in terms of being described as ‘pain’ rather than ‘injuries’, or not involving time off) in deciding whether to pursue a case.

- 5.14. In highlighting this difference, this is not to suggest that claims falling into the latter category are not merited. However, it does suggest that claims management companies have encouraged some people to make personal injury claims who would not otherwise have done so.

Evidence from other research

- 5.15. Personal injury is included in the English and Welsh Civil Justice Survey. This data reveals that fewer consumers resolve personal injury problems than other problem types - 42.3% either did nothing or gave up pursuing their problem before it was resolved⁵⁴. In research by the LSB, across legal services, 20% of consumers reported they had been in a situation where legal advice could have helped but they decided not to get it. However, in personal injury cases 37% who suffered a slip and trip, 27% a work accident and 21% road traffic accident did not obtain legal advice. Reasons for not getting legal advice included not knowing who to contact and not knowing how the process worked⁵⁵.
- 5.16. The Ministry of Justice commissioned research on claims advertising in preparation for the Compensation Bill⁵⁶. Advertising – in particular on TV – was the primary source of people’s awareness of personal injury compensation. Advertising can operate as a means of ‘normalising’ the activity of claiming: making it appear to be a common thing to do and therefore an increasingly acceptable option.
- 5.17. Moorhead and Cumming have considered the role of marketing for employment claims⁵⁷. Advertising appeared to have minimal impact on the propensity of claimants to claim and only a modest

impact on the choice of adviser. Claimants were primarily motivated to claim because their own notions of justice were violated by their employer and/or because of encouragement by their family, peer group and trade union. However, the researchers acknowledge the subconscious impact of marketing is unclear and that adverts could cement people’s feelings of injustice and prompt them to act.

- 5.18. The same report showed that over half of union claimants indicated that contact with their union had encouraged them to complain. This group was much less likely to indicate that discussions with friends, relatives or colleagues had influenced their decision, suggesting that union representatives act as an obvious first port of call and a replacement for social advice networks.

Does the impact on access to justice differ according to the type of consumer?

- 5.19. The Legal Services Consumer Panel represents the interests of different types of consumers. More sophisticated consumers, such as businesses and local authorities, are likely to recognise when they have a legal need, and are more likely to be repeat users of legal services. Therefore, introducers probably make little difference to access to justice for them.
- 5.20. Of more interest is whether the personal characteristics of individual consumers, for example differences in income or levels of education, mean that some groups of consumer are more responsive to the marketing efforts of introducers. The quantitative research suggests this is not the case. For example, research for the LSB indicates that 16% of consumers classified as ABC1 accessed legal services via an introducer compared to 12% of consumers classified as C2DE. The survey showed no discernible difference in levels of shopping around by different socio-economic groups. However,

the data does show differences in levels of knowledge about what lawyers do: 37% of ABC1 respondents claimed to have a great or fair deal or knowledge compared to 25% of C2DE respondents⁵⁸.

Financial services

- 5.21. A growth area for claims management companies is financial services following mass complaints about endowment mortgages, payment protection insurance (PPI), unfair bank charges and unenforceable terms in consumer credit agreements. The Financial Ombudsman Service (FOS) provides a free service to resolve consumer disputes. Despite this, the Chief Financial Ombudsman has reported that over half of complaints it received about PPI in 2008/09 were brought on behalf of consumers by claims management companies which typically charge a fee – usually a percentage of compensation awarded – for this service⁵⁹.
- 5.22. In financial terms, consumers would be better off going to the FOS directly, rather than use a claims management company. In some instances, consumers will be unaware of the FOS and are captured by the claims management company, some of which exaggerated the difficulty of achieving redress through misleading advertising. However, as with legal services, financial services are complex and some consumers value the ‘hand-holding’ service that claims management companies provide, even if it costs them more. The Ombudsman’s report acknowledges that claims management companies have led to some consumers receiving redress when otherwise they would not have claimed:

“Consumers can make a complaint direct to a business – or to the ombudsman service – free of charge. If they make their complaint through a claims management company, on the other hand, that company will charge a fee – usually a percentage of

any compensation awarded. These fees have been criticised as disproportionate – especially in relation to the effort or expertise that some claims management companies actually deploy. So it is questionable what advantage consumers gain by using such companies.

“But it is also undeniable that the marketing activities of claims management companies have succeeded in identifying a very large number of consumers who have suffered loss. And this has resulted in many people being paid redress when they would otherwise have received nothing.”

Analysis of claims data

- 5.23. Claims data illustrates changes in the legal landscape against trends in accident claims. The Law Society lifted its ban on referral fees in 2004, so variations in data after this could signal the impact of this policy change. However, the ban was widely flouted and widespread advertising by claims management companies was prevalent from the mid 1990s. In addition, there were other key developments: the introduction of conditional fee agreements (CFAs) in 2000; the ending of the “costs wars”; greater certainty following the introduction of fixed recoverable costs for motor claims in 2003; and the regulation of claims management companies in 2006.
- 5.24. All compensators are required to notify the Compensation Recovery Unit (CRU) of personal injury claims made against them. The CRU has provided data on claims notified in the period 2000/09 (see Table 6 overleaf).
- 5.25. The data shows that, outside of the motor category, claims notified to the CRU have been stable and even declined over the period. 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. However,

motor claims, which accounted for over three-quarters (76.9%) of personal injury claims in 2008/09, and which were stable between 2000/01 and 2004/05 (when referral fees were banned) have risen substantially in the last four years. Preliminary analysis of research for the Claims Management Regulator on the

impact of regulation on access to justice highlights: “a significant increase in people making personal injury claims as a result of road traffic accidents in relation to the number of people who have grounds for a claim”⁶⁰.

Table 6 – Claims notified to the CRU 2000/09

	Medical	Employer	Public	Motor	Other	Total
2000/01	10890	97675	94000	401740	7815	612120
2001/02	9773	97004	100663	400434	6252	614126
2002/03	7973	92915	109441	398870	6347	615546
2003/04	7109	79286	91177	374740	4874	557186
2004/05	7196	77765	86966	402892	4463	579282
2005/06	9301	74977	81305	460085	4313	629981
2006/07	8573	70783	79503	518817	4822	682498
2007/08	8876	87198	79472	551905	3449	730900
2008/09	9880	86957	86164	625072	3415	811488

Source: Compensation Recovery Unit

5.26. In seeking to explain this increase, it is difficult to isolate the impact of claims management companies from other causes. In addition to the legislative changes described above, the recession will also have had an impact. Tough economic circumstances tend to increase the propensity for people to make both valid and fraudulent claims. That said, the rise in motor claims after 2004 suggests that claims management companies had some impact in enticing more people into the justice system.

Have referral fees helped to fuel a compensation culture?

- 5.27. The Consumer Panel’s starting point is that everyone who suffers harm due to someone else’s fault should be enabled to claim compensation. However, “compensation culture” has become a term of abuse, which essentially refers to the development of a society where people make frivolous or made-up claims, often encouraged by “ambulance chasers”.
- 5.28. The Better Regulation Task Force examined the “compensation culture” in 2004⁶¹. It concluded that the compensation culture was a myth based on claims data, but the perception that it exists causes the real problem as the fear of litigation impacts on behaviour and imposes

burdens on organisations trying to handle claims. It noted claims management companies that previously dominated the market but subsequently collapsed – The Accident Group (TAG) and Claims Direct – fed an enormous number of claims into the system. In the view of the Task Force, the marketing of claims management companies had increased access to justice, but along with others had contributed to creating the myth:

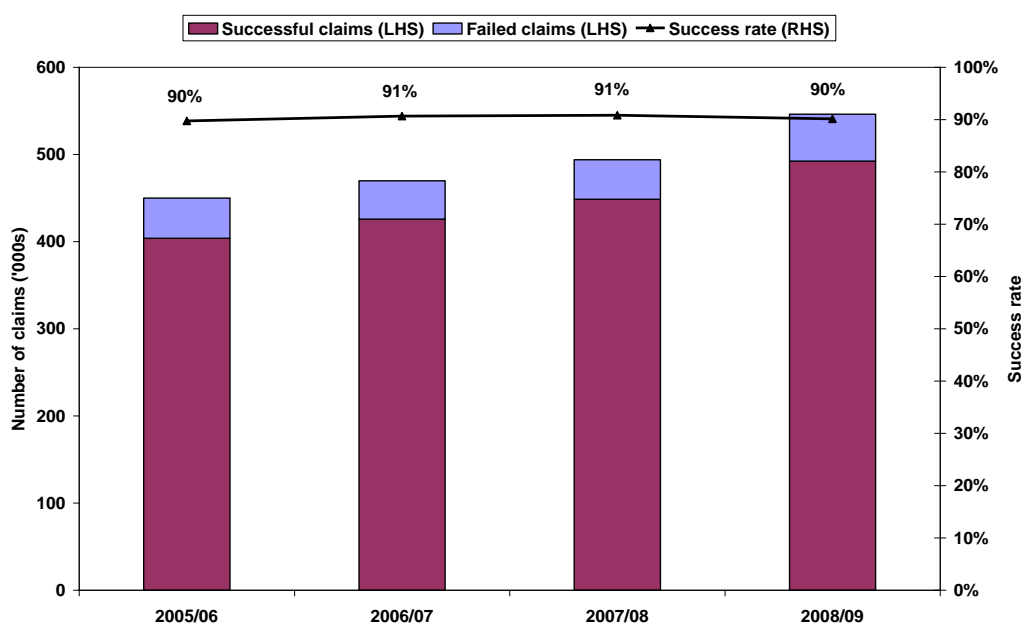
“Media reports and claims management companies encourage people to ‘have a go’ by creating a perception, quite inaccurately, that large sums of money are easily accessible.”

- 5.29. A key development since the report is that claims management companies are now regulated. An objective of regulation was to “tackle practices that have led to misperceptions and false expectations of compensation claims”. A report on the impact of regulation concluded that:

“Misleading advertising, organised cold calling and unauthorised marketing in hospitals has largely been dealt with. However, a different type of cold calling – through call centres – has emerged which is proving difficult to deal with. And misleading advertising has been replaced by misleading information being given in sales calls.”⁶²

- 5.30. The CRU collects data on the number of cases settled by compensators. If settlement rates were low, or there was a significant downward shift after 2004, it could be argued that claims management companies have helped to fuel a compensation culture by facilitating an increased number of cases that insurers consider invalid, and thus therefore unwilling to settle. In fact, as the data in Figure 3 demonstrates, the opposite is the case. Nine in every ten claims are settled by insurers and this figure has remained constant since 2005/06.

Figure 3 - RTA claims and success rate 2005-09



Source: CRA Study

- 5.31. The incentives operating in the market should filter out many spurious claims early. Lawyers will not be remunerated if they lose a case, so they will not pursue bad cases. As discussed earlier, a criticism of referral fees is that they deter lawyers from taking on borderline cases. Furthermore, lawyers paying a subscription will stop using introducers who pass them bad cases so there is an incentive for introducers to filter cases.
- 5.32. Insurers may make a commercial decision to write off low value claims as the legal fees mean it is not worth the risk, even if liability is disputed (for example, in a whiplash case where the extent of injury is difficult for medical experts to assess). However, this is not because of the referral fee, but results from the difficulty of disproving fraudulent claims.

Summary of key points

- Research shows there is significant unmet legal need, particularly among the socially excluded, and that consumers' ability to access the justice system is highly dependent on how effectively they are connected to legal advice. The advice sector has an important connecting role, but it cannot alone fill the gap.
- Consumers value the marketing of claims management companies on two levels: they encourage people to claim who might not otherwise have done so; and their superior client care skills help people to use the justice system when they are at their most vulnerable. Referral fees also help not-for-profit bodies, such as unions, to perform a similar access to justice role.
- Statistical data suggests that payment of referral fees to claims management companies has resulted in more people bringing RTA claims
- People with more serious injuries are already intent on making claims so that claims management companies just influence the selection of lawyer. By contrast, those with less severe injuries were less inclined to bring claims before the intervention of claims management companies. However, while there is an undercurrent of hostility towards the so-called "compensation culture", the high rates of settled cases in RTA claims (over 90%) and the economic incentives for lawyers to weed out weak cases, would suggest this phenomenon does not exist on any great scale.

6 Competition

Introduction

- 6.1. In its Annual Plan 2010/11, the OFT sets out the benefits of competition:

*“When markets work well businesses thrive by providing what consumers want, better and more cost-effectively than their competitors. As such, effective competition provides significant benefits for consumers through greater choice, lower prices and better quality goods and services. Competition also provides strong incentives for firms to be more efficient and innovative, helping raise productivity growth across the economy.”*⁶³

- 6.2. One of the regulatory objectives in the Legal Services Act is to “promote competition in the provision of legal services”. This section discusses the operation of competition in markets with referral arrangements and their impact on:
- The quality of legal services;
 - The cost of legal services; and
 - The choice of providers, as reflected in the diversity of the supplier base.

Competition in markets with referral arrangements

- 6.3. Without introducers, law firms compete only against each other to attract clients. However, referral arrangements place an intermediary between the lawyer and consumer, altering the dynamics of competition. In effect, competition operates at two levels:
- Tier 1 – competition to attract consumers, between introducers who generate income from referrals, and

between law firms to attract consumers directly.

- Tier 2 – competition between law firms to occupy spots on introducer panels in return for guaranteed work.
- 6.4. In an ideal market, competition in Tier 1 is based on which business (be it introducer or law firm) offers the package that best meets the consumer’s needs, while competition in Tier 2 is about introducers finding those firms that will best meet the needs of their customers. The extent to which this ideal happens will depend on: whether consumers drive competition; the basis on which introducers drive competition between firms for access to their panels; and whether all firms can compete equally for access to panels.

Do consumers drive competition?

- 6.5. Consumers can drive competition when there is a good choice of providers and they are empowered to make informed decisions. In the absence of one or both of these conditions, power shifts to the service providers in dictating the services on offer and the terms on which they can be accessed.
- 6.6. There is a wide choice of providers. In conveyancing, there are currently over 9,000⁶⁴ solicitors and licensed conveyancers, in a market that undertook 859,000 conveyancing transactions in 2009 (down from 1.6 million in 2007).⁶⁵ There are just over 6,000⁶⁶ solicitor firms working in personal injury, with 735,000 personal injury claims per year, of which around 250,000 are handled outside of unions and BTE insurers⁶⁷. One

commentator has suggested that there are too many qualified lawyers and law firms.⁶⁸

- 6.7. Despite the wide choice of lawyers, consumers are not driving competition through their purchasing power. In part, this is explained by asymmetries of information. Consumers lack the expertise to tell a good lawyer from a bad one due to the specialised nature of the law and because they rarely use legal services. As one participant in the focus groups said:

“There’s a massive choice, it’s just knowing who’s who”. Another said: “It’s very difficult to pick them other than at random”.

- 6.8. Inertia also plays a strong role. Consumer research undertaken for the LSB in December 2009 indicates that only 14% of adults who sought legal advice in the last 5 years ‘shopped around’.⁶⁹ Instead, the most common method of choosing a lawyer is via recommendations from friends, family and colleagues⁷⁰.
- 6.9. The main reason for this inertia is likely to be that consumers value the convenience of following a recommendation, which they view as a signal of quality, even if it might mean paying more⁷¹. The LSB’s consumer research indicated that, of those consumers who did not shop around, 77% said this was because they neither needed nor wanted to⁷². Equally, the OFT Market Study into home buying and selling found that just under half (48%) of those who accepted a estate agent recommendation for a lawyer did not investigate other options, the most common reason being that it was *‘easier/more convenient to accept the recommendation’*.⁷³
- 6.10. Another factor is an assumption that standard services, such as will-writing or conveyancing, cost roughly the same across the market so there is little benefit in shopping around. Price comparisons can be difficult to undertake as the ‘headline’ prices offered by some firms do

not reflect actual costs, and, even when all costs are included, there is a lack of consistency in the presentation of prices, such as the names of charges or clarity between service fees and third party charges. This makes it difficult for consumers to compare like-with-like.

Can introducers drive competition?

- 6.11. In the absence of consumers driving competition, it is possible that introducers stimulate competition between providers by exercising a ‘filtering’ function. As introducers are experienced users of lawyers who command significant purchasing power, they can insist that firms meet certain conditions, such as the size of legal fees charged and specific service standards. The key issue for users is the basis on which the introducer filters, that is whether this is on the same basis on which a consumer would make choices. As discussed in the section on independence, the interests of introducers and consumers are generally aligned. However, while introducers and consumers may want the same outcomes, introducers might be less concerned about how these are reached. This could have implications for service quality, especially as introducers will want to maximise income from referral fees while lawyers will be keen to minimise their costs.
- 6.12. In broad terms, the profit made by lawyers is the difference between the fee they charge and the cost of doing the work. Expenditure on marketing to obtain work, whether through a referral fee or another route, is just one of the costs that reduce profits. Historically, weak competition in legal services has permitted law firms to enjoy good profits while being inefficient. Referral fees have probably made law firms more efficient, but the question is whether this has reached a stage where firms are now efficient and face no option but to reduce quality to maintain profit.

6.13. Quality is of most concern where legal fees are fixed or capped, as this limits the ability of lawyers to increase prices to offset increases in referral fees. For example, the Government prescribes the level of legal fees in RTA personal injury claims valued at £1,000-£10,000. Some introducers set the prices that panel solicitor firms charge clients for conveyancing, in which case the profit that law firms make depends on the amount of time allocated to the work, creating an incentive to minimise effort. This is particularly relevant as the Jackson Report recommended a significant expansion in fixed costs regimes.

The impact of referral arrangements on the quality of legal services

6.14. Quality in legal services covers both outcome and service. On one level, it relates to the outcomes achieved for clients, which depends on the competence of the lawyer and the level of effort exerted. A second level is the service provided, including timeliness and communication. Lawyers can deliver a good outcome for clients, but offer poor client care. For example, work on a personal injury claim might result in a fair compensation award, but the process

takes longer than necessary because the lawyer failed to prioritise the case.

Evidence from consumer surveys

6.15. The Ministry of Justice commissioned the National Centre for Social Research (NatCen) to conduct a baseline survey to assess the impact of the legal services reforms⁷⁴. The aim was to provide robust, nationally representative data about consumers' experiences of legal services for personal matters in England and Wales. The findings revealed high levels of satisfaction: 91% of consumers felt that they received a good service, 92% felt that their lawyer acted in their best interests and 92% were satisfied with the outcome of their matter.

6.16. We asked NatCen to reanalyse the data to see whether the route by which consumers found their lawyer made any difference to the service they received. The data reflects the overall market, as the sample size for different types of law (e.g. personal injury) were too small to draw reliable conclusions. The top-level statistics for outcomes and satisfaction are summarised in Table 7 below; this should be read alongside the full table in Annex 5.

Table 7 – Satisfaction with outcome and service by selection method

	Satisfied with outcome	Not satisfied with outcome	Satisfied with service	Not satisfied with service
Word of mouth	93.5%	6.5%	91.9%	5.9%
Used before	93.8%	6.2%	93.1%	5.1%
Referral	91.1%	9.0%	91.5%	7.0%
Other	90.2%	9.7%	88.3%	10.0%

Source: Ministry of Justice/National Centre for Social Research

- 6.17. The results indicate no statistically significant differences, with two minor exceptions, between selection routes. Consumers are only marginally less satisfied with both the outcome and the service received when a lawyer is chosen via a referral compared to a recommendation by family or friends, or returning to a lawyer used before. The only categories of service in which the difference is statistically significant are approachability and knowing what was going on with their matter. Satisfaction ratings for referred clients marginally exceed those for lawyers found by other methods (including shopping around).
- 6.18. We would expect satisfaction to be higher when the lawyer is “tried and tested”, that is they have been used before or come with a personal recommendation, as the lawyer has been filtered whereas other methods are more random. The data indicates that a personal recommendation is a more effective filter than that provided by introducers, but not significantly so. Satisfaction levels with both outcome and service are anyway very high for all selection methods. Therefore, it is difficult to argue that clients receive worse outcomes or levels of client care due to referral fees.
- 6.19. The qualitative consumer research, although on a small scale, suggests that levels of client care may be lower for personal injury work than other areas of law. While participants reported both good and bad experiences with lawyers across the spread of legal issues, personal injury claimants were less happy with the client care. However, this mattered far less to these consumers because they were not paying their legal fees. They appeared willing to accept slightly lower levels of service in the hope that they would achieve a lump sum payment at the end.
- “If you want great service, a Personal Injury lawyer is not where you want to be”*
18-34, ABC1, PI depth
- 6.20. Submissions to the Consumer Panel from practitioners included accounts of clients having bad experiences from conveyancing firms processing volume work. For example, Brethertons LLP described:
- “Customers who have used firms paying referral fees complain they have difficulty speaking to anyone who understands the particular details of their case, calls are not returned promptly, special instructions are declined as the conveyancer can only work in a set way, deadlines imposed by external factors such as requirements by someone further up the ‘chain’ are ignored.”⁷⁵*
- 6.21. Referral fees have facilitated the emergence of national firms conducting large volumes of work. Such businesses use paralegals supervised by qualified lawyers, IT systems and no face-to-face advice. This business model allows firms to keep their costs low and offer prices below the market average. However, while referral fees facilitate volume businesses, any reduction in quality, is not necessarily caused by the referral fee itself, but reflects the nature of the business model. Across the economy, consumers always make trade-offs between price and quality. It is a matter of consumer choice whether people accept a reduced quality of service in exchange for paying less, or whether they are willing to pay extra in return for a more personalised service.
- 6.22. This should not be a concern for regulators unless standards slip too far and affect outcomes. In the context of conveyancing, the CRA study produced convincing evidence that quality does not suffer where referral fees occur, either in relation to substantive advice or service. Indeed, estate agents reported that lawyers paying

referral fees were more likely to be faster at completing the conveyancing process⁷⁶.

- 6.23. Regulators can help consumers overcome the problem of judging the quality of the legal services providers. This involves raising awareness so that consumers know what to look out for and publishing information, such as firms' complaint records, to help consumers to identify good lawyers. This can harness consumer power to improve compliance and drive competition. We note the Financial Services Authority is requiring firms to publish information on how they handle complaints and will publish its first set of consolidated data in September 2010⁷⁷.

Positive drivers for quality of service

- 6.24. While most of the outside commentary is on the incentives for lawyers to reduce quality in order to recoup the cost of referral fees, there is some evidence that service standards actually improve.
- 6.25. Introducers have greater knowledge of the legal market than consumers and can better evaluate quality. Introducers who have an ongoing relationship with their customers and operate in a highly competitive market risk losing customers to rivals if the quality of advice provided by lawyers to whom they refer work is poor. It is in the interests of introducers to insist panel solicitors meet certain service standards, in areas such as timeliness and communication. The guarantee of regular income, plus the risk of losing their panel place to another firm, means solicitors have a strong incentive to adhere to these service standards and deal responsively with complaints.
- 6.26. This was reflected by Irwin Mitchell:
- “Service level agreements, typically imposed by institutional intermediaries such as LEI insurers, will ensure that their customers receive fast and efficient services from panel firms that risk*

*penalties for non-compliance with service standards. The intermediary that has a well-established national brand to protect and enhance will only deal with suppliers of legal services (or any other service) if they are confident that the supplier will similarly protect, enhance and not taint that brand with its allied loyal consumer base”.*⁷⁸

- 6.27. Whereas lawyers have a deserved reputation for quality of advice, as complaint figures recorded by the Legal Services Ombudsman backs up, their performance in relation to softer client care skills is less strong⁷⁹. Indeed, as Minster Law argued in its submission⁸⁰, while regulators cover basic client care requirements within their codes of conduct, rarely is good service provision monitored to the extent that brands monitor and enforce service standards. The SRA code of conduct is viewed by much of the profession from a compliance perspective rather than a client service perspective.
- 6.28. Firms interviewed for the Moulton Hall study⁸¹ that paid referral fees reported the level of service they provided had stayed the same or improved. They referred to the need to invest in new technology and worried about being removed from panels if standards slipped. This view is supported by Thorneycroft Solicitors⁸²:
- “the cost of referral agreements has increased over the last few years due to the number of firms that have been attempting to get on these panels, but it is only the firms that have maintained good service levels that have managed to stay on these panels”*
- 6.29. The promise of regular work enables firms to invest in IT, such as sophisticated case management tools, which can drive improvements in quality and lead to innovation. Examples provided by introducers in relation to conveyancing included: no sale, no fee agreements or

fixed fees; longer opening hours and case tracking online. One chain of estate agents argued that the rest of the industry has been forced to follow suit, suggesting that referral arrangements are having a wider impact beyond those firms receiving work from introducers.

The impact of referral arrangements on the cost of legal services

- 6.30. Opponents of referral fees argue that introducers make easy money for little effort and demand fees that lawyers have little choice but to pay in order to stay in business, adding unnecessary costs which consumers and taxpayers end up paying. On the other hand, supporters of referral fees argue that the economies of scale enjoyed by introducers mean it is cheaper for lawyers to acquire business via referrals than for each to market their services directly.
- 6.31. In conveyancing and personal injury, legal services are paid for in different ways:
- Legal services paid directly by consumers – conveyancing
 - Legal services paid by others – personal injury

Legal services paid directly by consumers - conveyancing

- 6.32. For the majority of consumers taking part in our research, the impact on price was the primary concern around referral fees. Legal fees were generally thought to be high – “a licence to print money”⁸³ – and discovering referral fees created a sense of indignation. Consumers assumed that any referral fee would be added to their bill, making the service cost more than if they had gone to a lawyer direct. Transparency was seen as key, as it enabled them to search the market for more competitive rates; if the price was competitive, they might stick to their

original choice, but if not, they would vote with their feet.

- 6.33. Law firms face choices about how to meet the cost of referral fees:
- The fee is passed onto the referred consumer. This means that referred clients pay higher prices than those accessing the firm direct.
 - The fee is passed on and spread across all clients, irrespective of whether they were referred. The referral fee forms part of the general fee structure and all clients pay the same for the same legal service.
 - The fee is borne by the firm through reduced profit margins. The price charged to consumers is the same as if the firm did not pay referral fees.
- 6.34. Various permutations are possible, for example firms could pass on some of the referral fee to consumers and absorb the rest in profits.
- 6.35. A survey of solicitors in 2005 provides useful insights⁸⁴. 70% of those who had paid referral fees agreed that they were ‘an alternative form of marketing’. Only 40% said that referral fees had an impact on the amount they spent on marketing. Of those who said there had been an effect, 57% said their marketing had increased while 43% said it had decreased. 89% of solicitors who paid referral fees claimed they did not pass the cost on to clients. 9% said they always passed on the cost, although 17% of those paying referral fees for conveyancing said they always passed them on – and a further 4% would pass them on if possible.
- 6.36. In the Moulton Hall survey, all firms said they did not recoup referral fees directly from clients – instead they are acquisition costs treated no differently from advertising or marketing. Firms reported they either accepted the additional cost or tried to reduce other costs. A few said that the

referral fee was 'built into the cost' of the fee charged to the client or that the fee for cases where referrals are paid was marginally higher than non-referred work.

- 6.37. Two conclusions can be drawn from this. First, that many firms consider referral fees to be a cost-effective form of marketing (although the size of fees has risen since the first survey was carried out). Second, that the majority of firms treat referral fees as an overhead just like any other marketing cost, and absorb this by seeking efficiencies elsewhere. Where referral fees are a more costly form of acquiring business than other marketing options, this might be reflected in higher prices charged to all consumers, and in a minority of cases, in marginally higher prices charged to individual clients.

Do referral fees lead to increased costs?

- 6.38. There is a general view that referral fees have added to the overall cost of legal services. As one firm put it:
- "referral companies inevitably add an extra layer of administration...referral companies seek to make a profit...it is therefore inevitable that referral arrangements result in increased rather than reduced costs".*⁸⁵

The Hampshire Law Society reported that *"consumers [have been] charged significantly more for a simple conveyancing transaction than the typical market rate, and...this is due to the payment of a referral fee"*⁸⁶

- 6.39. The economic literature suggests that the longer, or more complex, the network of intermediaries, the more likely that costs will be loaded into the process as each will charge a fee for the value they add to the process. Although referrals reduce search costs and provide a service that matches their needs, consumers might be worse off should these benefits be outweighed by

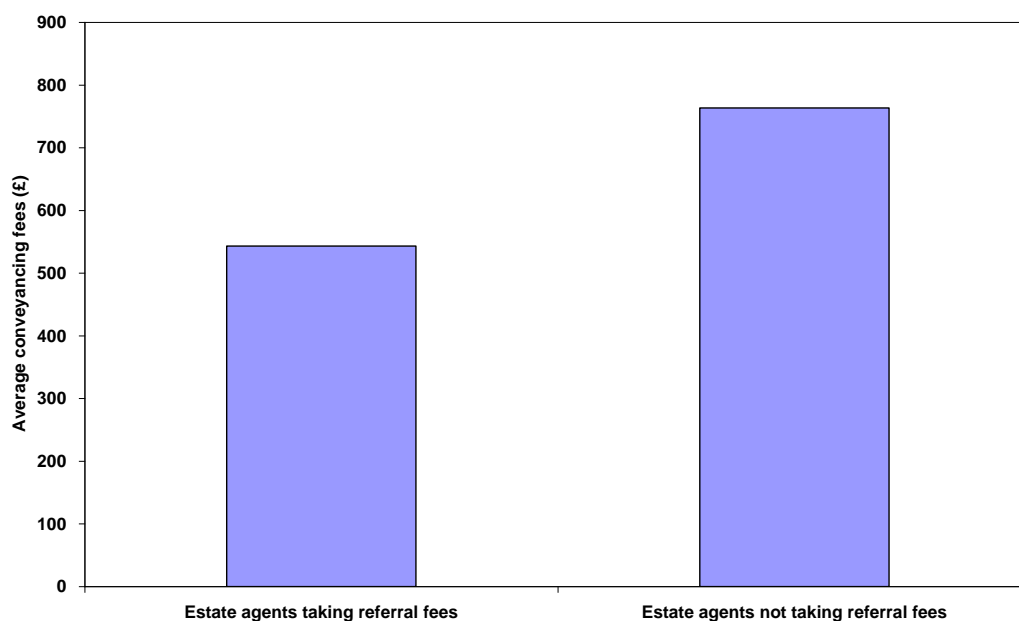
the loss from increased prices in the market⁸⁷.

- 6.40. However, the CRA analysis suggests that even though referral fees in conveyancing have increased, average conveyancing fees charged for a property valued at £200,000 are cheaper among firms that pay referral fees compared to those that do not - £543 compared to £687⁸⁸ (see Figure 4). CRA explain this as the guarantee of regular work enabling investments in technology that led to cost efficiencies that are passed onto consumers. Indeed, 50% of estate agents surveyed saw the greatest advantage to the consumer of referral arrangements being lower conveyancing costs.
- 6.41. This analysis was supported Minster Law, which argued:

*"the increases in competition to win [conveyancing] business whether direct or through referral arrangements has led to a massive reduction in cost to consumers thereby benefiting consumers as a whole and resulting in some of the lowest costs worldwide and certainly in Europe."*⁸⁹

Some introducers require referrals costs to be internalised. For example, Contact Law demands that their panel firms guarantee to charge clients the same fee as if they came directly to them - however firms must also pay Contact Law 15% of their profit on each case. It is common for introducers to cap or set the fees that conveyancers charge to clients.

- 6.42. By guaranteeing lawyers large numbers of cases, introducers can deliver additional benefits that mean consumers pay less. Examples include reduced premiums on legal indemnity insurance, no search insurance on remortgages, and a free HIP. There is a view that these benefits drive competition across the industry, as non-referral firms are forced to match these benefits in order to survive.

Figure 4 – Comparison of conveyancing fees

Source: CRA study

Legal services paid for by others – personal injury

6.43. The vast majority of personal injury claims are funded on a CFA, so claimants do not pay their legal costs (see Annex 4 for a brief description of funding of civil litigation in personal injury). For this reason, participants in our consumer research were unconcerned about excessive referral fees. In the words of one personal injury claimant we interviewed:

“I wouldn’t give a monkey’s because that’s the insurance company that’s going to sort it out.”⁹⁰

6.44. Nevertheless, it is in the consumer interest to keep the costs of litigation to a minimum as insurers – who foot the bill – pass these on to policyholders through higher premiums. Technically, referral fees are not recoverable from the losing party, but in practice they are factored into calculations of the solicitor’s base costs which in part make up the centrally set fixed fees or hourly rates.

A controversial issue

6.45. The escalating costs of civil litigation have been considered by Lord Justice Jackson. His conclusion, reflecting the view of many, is that referral fees have inflated the costs of litigation:

“Referral fees constitute a major head of expenditure in personal injuries litigation, which claimant solicitors have to recover from defendants if they are to operate profitably. Accordingly referral fees, although not recoverable as a discrete item of costs, have a substantial impact upon the costs of personal injury litigation.”⁹¹

6.46. However, this view is not uniformly held. UNISON suggests that “referral fees have not driven up the levels of personal injury litigation costs, but rather impacted on profit margins”⁹². Equally, Minster Law suggests that referral fees do not increase claim costs, rather it is “irresponsible file handling practices on the part of overly aggressive and unreasonable solicitors

*and inefficiencies on the part of insurers which is responsible.”*⁹³

6.47. The CRA study notes that the level of referral fees has stabilised in recent years. Overall, they are constrained by the level of costs which are recoverable and this, combined with limits on the extent to which further efficiency gains might be possible, explains this trend. CRA notes that referral fees do not affect the price of legal services where the level of legal costs are prescribed, but there could be an effect if the price of legal services is partly determined by factors which include the cost of referral fees. However, assessing this was beyond the scope of its report.

6.48. The Association of British Insurers (ABI) commissioned a report by Oxera⁹⁴ which concluded that referral fees explain why the hourly rates paid by claimant solicitor firms (set centrally) are 30% more than the hourly rates paid by defendant solicitor firms (where rates are determined in the open market). The Advisory Committee on Civil Costs has also concluded that referral fees explain the difference:

*“So in the PI sector, the gap between claimants’ and defendants’ solicitors rates can be entirely accounted for by extra marketing costs/referral fees, which are additional costs which claimants’ solicitors appear to find it necessary to incur. One may conclude from this that if defendants’ solicitors are not making excess profits from the system, then neither are claimants’ solicitors. This does not, however, exclude the possibility that referral fees are sustained above the ‘market rate’ because the GHRs are too high in PI cases and this enables claimants’ solicitors to overpay.”*⁹⁵

6.49. The Oxera analysis⁹⁶ argues that in a competitive market costs would be reflected in the prices that consumers pay; if consumers were responsible for paying their own solicitor’s costs, this would

constrain the level of referral fees to how much consumers were prepared to pay. However, since consumers do not pay their legal fees in personal injury, solicitors are induced to a higher level of marketing spend than is necessary to entice genuine claimants. As evidence of this, marketing spend in RTA cases (where a referral fee of £900 accounted for 40% of the legal costs recovered from the at-fault party) is far higher than found elsewhere, both in other economic sectors and where marketing is used to entice consumers to make claims (such as financial services claims) or change their behaviour (such as public health campaigns).

6.50. Referral fees have reached eye-watering levels. There is force in the argument that the size of referral fees reflects the value of work to lawyers, rather than the acquisition costs of introducers. Although it is also true that lawyers can afford to pay fees of this size. This might suggest the rise in referral fees is explained in part by supply exceeding demand.

6.51. In commenting on the case made by insurers, the Advisory Committee on Civil Costs observed that it is unsurprising that marketing costs in personal injury are higher than for other legal work, as advertising is less necessary when a person needs to enter the legal system in order to achieve their objective (such as to get a divorce). The Committee also found that claims management companies were not making excessive profits, but instead *“appear to be setting prices at a mark-up on costs which is standard for the overall sector in which they are located”*⁹⁷.

6.52. Nevertheless, the Committee was unable to determine whether a reduction in hourly rates leading to a reduction in referral fees would either lead to a contraction of the claims management industry and hence a reduction in access to justice or to a more efficient business model in claims

management with only minimal reduction in access to justice.

Impact of a ban on referral fees on BTE premiums

6.53. The Jackson Report recommended positive efforts to encourage the take up of BTE insurance to promote access to justice.

6.54. BTE insurers earn income from referral fees, thus any ban would close off this revenue stream, which could cause BTE premiums to rise. However, Aviva, the UK's largest insurer, suggested:

“as long as the ban was not conducted in isolation but as part of a package of reforms including reducing hourly rates and fixed costs, then insurers would be prepared to forego this income stream in return for lower overall legal costs. This would ultimately benefit consumers as a lower legal costs bill would be reflected in premiums”.

The impact of referral arrangements on the diversity of the supplier base

6.55. There is a suggestion that referral arrangements disadvantage small law firms as introducers prefer to deal with larger firms. The Consumer Panel does not favour one business model over another, but recognises that a diversity of suppliers promotes competition by increasing consumer choice.

6.56. The Solicitors Sole Practitioner Group of the Law Society reflected a concern of a number of law firms and sole practitioners:

“those lawyers who pay referral fees do so at the expense of those who do not, or will not, resulting in a distortion of the market place. Some lawyers have as a result ceased practicing in that area of law as this can result in the practice becoming unviable. This results in a lack of

competition amongst lawyers and less choice for consumers.”⁹⁸

6.57. This argument has some logic: if access to panels is granted on the basis of who pays the highest referral fees, this would advantage firms that are in a strong enough commercial footing to pay them. The investment in IT and sophisticated case management systems on which introducers insist could also pose barriers to entry for smaller operators.

6.58. More generally the finite amount of work to share around limits the availability of panel places. Interviews of insurers conducted for the CRA study suggests they are seeking to reduce the number of personal injury law firms on their panels⁹⁹. Further, incumbents are likely to have work as long as they maintain quality. Interviews of estate agents suggest it is relatively rare for panel members to change¹⁰⁰.

6.59. The gravitation of conveyancing and personal injury work to large panels raises competition concerns that a small number of players could dominate the market:

“the current market provides opportunities for large referral organisations to capture the lion’s share of the market...the shift has been to place a large portion of the market in the hands of a few large organisations, restricting competition, particularly in terms of service level.”¹⁰¹

6.60. The Legal Services Institute noted:

“the control that [national branded networks or membership bases] do or might exert over access to legal services...could be compounded by processes that require providers of legal services to pay significant referral fees to secure their access. This might in turn lead to a number of market-dominant players whose presence and actions could result in the disappearance of many (probably smaller) law firms for whom the playing field is anything but level.”¹⁰²

6.61. However, it is unlikely that panels will provide the only route to a lawyer. In conveyancing, the majority of consumers find their lawyer by another method, and many reject the recommendation of their estate agent. Furthermore, the emergence of solicitor collectives and marketing alliances is evidence of the legal profession challenging external introducers. Such arrangements may provide access to a broader market for smaller law firms, allowing them to provide services both within and beyond their

geographical area, essentially competing at national level and providing them wider distribution networks for their services.

6.62. The emergence of comparison websites should provide an alternative way for lawyers to market their services and this could exert downward pressure on the size of referral fees. Later this year, the Consumer Panel will examine whether the emerging comparison websites in the legal services market are working in the consumer interest and will draw up good practice standards.

Summary of key points

- Consumers have a wide choice of law firms, but they are not driving competition between firms. However, introducers can stimulate competition by exercising a filtering function that matches their customers to suitable legal services. The key issue is whether introducers filter on the same grounds as a consumer would make choices.
- Introducers' economic incentives are to ensure law firms provide good quality work. Investment in IT and case management systems allowed by the regular flow of work guaranteed by introducer panels, has improved standards and led to innovation. Yet referral fees are costs which lawyers must recover. Referral fees have driven efficiencies, but there remains a question as to whether this has reached the stage where firms can only afford to pay referral fees if they cut costs by reducing quality.
- Quantitative research shows no statistically significant differences in overall satisfaction with outcomes and service where firms are chosen via a referral. Qualitative consumer research suggests some personal injury claimants are receiving poor client care, while law firms report complaints by clients using volume business models. However, any such reduction is a function of the business model, not the referral fee, and consumers are free to make trade-offs between price and quality.
- Intermediaries normally increase prices paid by consumers. However, conveyancing fees are actually less among firms paying referral fees. In personal injury, referral fees appear to be reflected in centrally set fixed fees and hourly rates. The impact of referral fees on the costs of civil litigation is contested. There is agreement that referral fees account for the gap in hourly rates charged by claimant and defendant solicitors. While insurers argue referral fees are excessive, the Advisory Committee on Civil Costs has concluded that claims management companies do not make excessive profits.
- The gravitation of conveyancing and personal injury work towards lawyers on large introducer panels has implications for consumer choice; this should be monitored by the competition authorities. However, consumers will always access legal services through multiple routes, while lawyers are mobilising to compete with introducers.

7 ABS

Introduction

- 7.1. Alternative Business Structures (ABS) are a central part of the Legal Services Act 2007. Their introduction is designed to open up the legal services market to increased competition by allowing a much greater diversity of business arrangements and ownership structures. ABS are a new type of law firm which can be owned by non-lawyers and can provide both legal and non-legal services. In practice, this might mean the establishment of new businesses that provide a range of different services all under one roof, such as estate agency and conveyancing, or it might mean that large national retail chains open their own law firms on the high street. ABS will be subject to a licensing regime operated by Licensing Authorities approved by the LSB.
- 7.2. This chapter examines:
- whether ABS is likely to change the use of referral arrangements;
 - the impact ABS could have on the transparency of referrals; and
 - the interactions between a ban on referral arrangements and ABS.
- 7.3. This chapter assumes, for the sake of argument, that referral arrangements still continue to be permitted between non-lawyers and lawyers and ABS would be required to comply with similar disclosure requirements to those placed on solicitors' firms and licensed conveyancers. Equally,

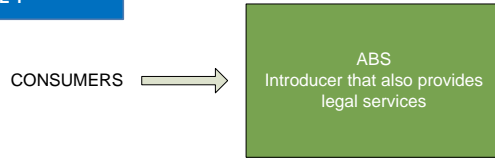
it assumes that Licensing Authority regulation of reserved and unreserved activities delivered by an ABS would be consistent with the approach taken to regulating these activities by the relevant Approved Regulator.¹⁰³

Will ABS change the use of referral arrangements?

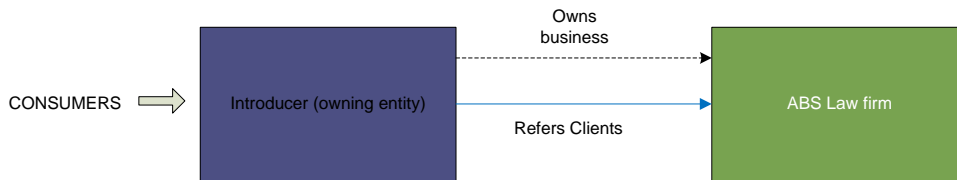
- 7.4. The introduction of ABS will increase the range of business arrangements available to law firms. While the possible permutations are very large, there are a number of business models which are likely to have an effect on referral arrangements:
1. An introducer becomes an ABS (that is, an introducer provides legal services directly to clients in addition to its other services)
 2. An introducer purchases an ABS (that is, an introducer offers clients legal services from a law firm it owns)
 3. An external body owns one or more introducer businesses and an ABS (introducers and ABS are part of the same business group, with introducers expected to offer clients legal services provided by the ABS - this is essentially the same as 2, except that the owner is separate from the introducer)
- 7.5. Figure 5 illustrates how a consumer could be referred to an ABS law firm in each case.

Figure 5: ABS Models

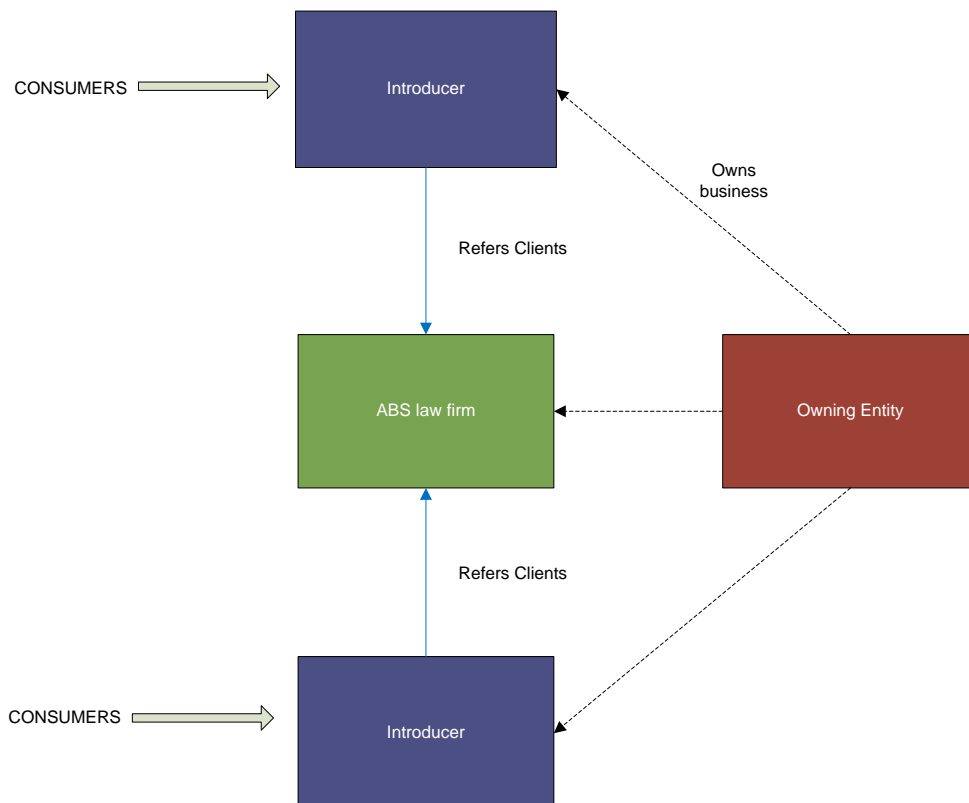
MODEL 1



MODEL 2



MODEL 3



- 7.6. Some of these models already exist in conveyancing, as Council for Licensed Conveyancer (CLC) Rules have allowed external ownership of licensed conveyancing firms since 2000. Major examples include Countrywide Conveyancing, which is owned by *Countrywide Plc*, and Premier Property Lawyers, which is owned by *My Home Move*. Around 25% of CLC-regulated practices could currently be categorised as ABS, as they have managers/owners who are not licensed conveyancers and are not authorised persons.¹⁰⁴ The above models are also possible to some extent under existing rules for solicitors. For example, a solicitors firm can own an introducer business (for example, the InjuryLawyers4U alliance is co-owned by a range of solicitors firms), or it could provide its own marketing and claims management services in-house.
- 7.7. ABS will allow these models to be used more broadly within the legal market, with solicitors firms being able to become part of broader business groups, or the business model used in conveyancing being adapted to personal injury.
- 7.8. From a referral perspective, a key outcome is that legal services could be more internalised within businesses, with consumers referred to in-house services, rather than to separately operated law firms on an introducer's panel. This is foreseen by Minster Law:
- “Alternative Business Structures will arguably not require the sophistications of referral fee arrangements having instead the ability to co-own or profit share”¹⁰⁵.*
- 7.9. Under the models in Figure 5, the need for any 'referral fee' disappears as it is an internal transfer of client rather than a referral to a separate business.
- 7.10. Depending on the market share that shifts to ABS models, one impact could be that traditional law firms have decreasing

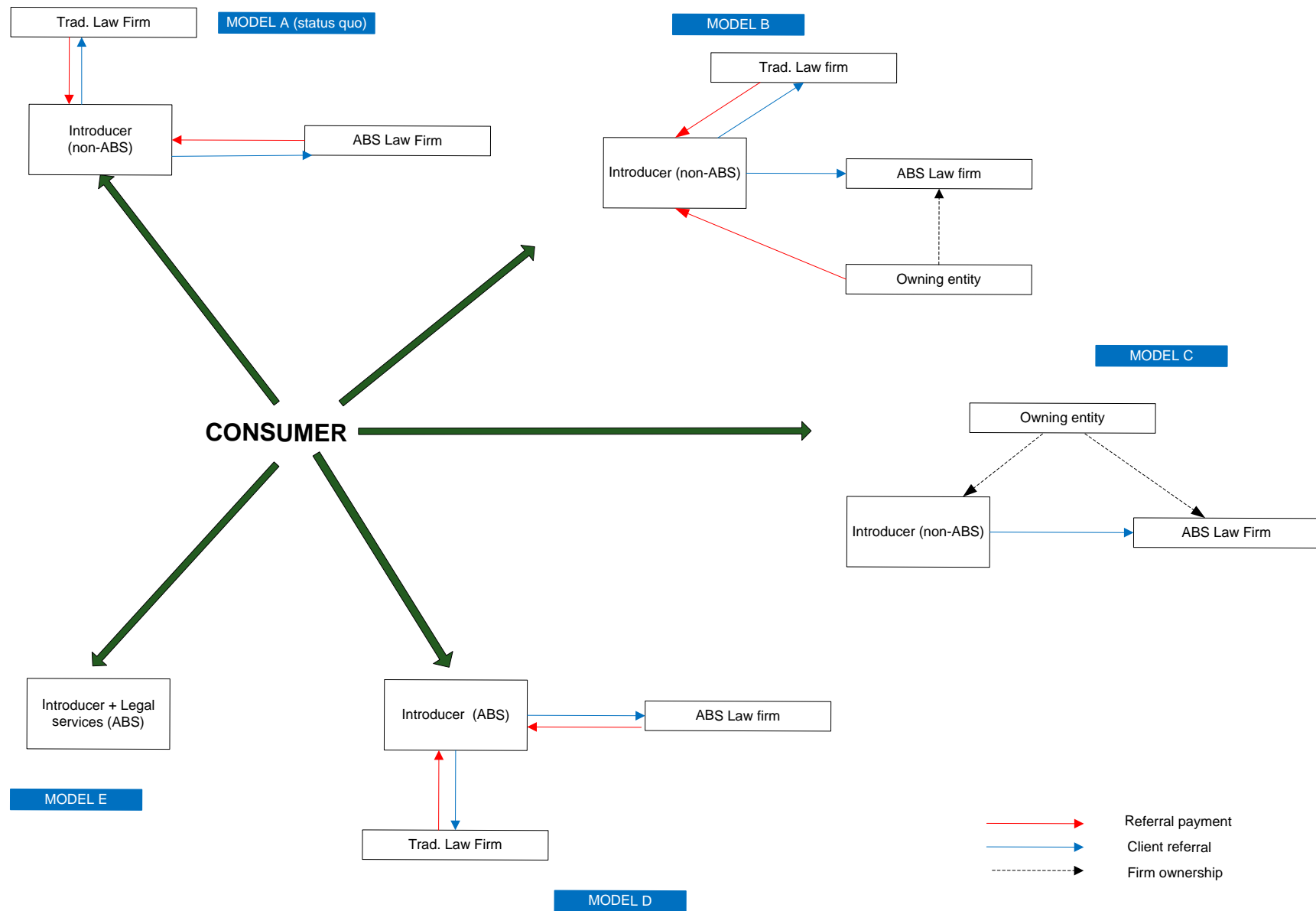
access to the work of large introducers, who may decide it is easier, from a budgetary, cultural and quality perspective to deliver legal services in-house or through firms within its business group. Given the importance of reputation to national brands, this would seem particularly feasible for banks, insurers, supermarkets or motoring groups.

- 7.11. However, ABS will not exclude the use of paid referral arrangements, as it is unlikely to be the preferred approach of all introducers or law firms. Some estate agency chains may not want to bring the risks associated with legal services in-house, and some claims management companies may not want the additional costs of compliance associated with an ABS. Nobody knows what will transpire when the ABS regime starts, but 25% of licensed conveyancing firms have chosen ABS models under the existing CLC rules and a survey in the legal professional press indicates that around 40-50% of solicitor firms are considering changes that would result in them becoming ABS.¹⁰⁶

Impact on transparency

- 7.12. Figure 6 illustrates ways in which consumers could access ABS firms through introducers.
- 7.13. Based on the assumption that ABS would be required to comply with similar disclosure requirements to those placed on solicitors' firms and licensed conveyancers, the following might be observed:
- Consumers using model A (a non-ABS introducer who has a panel of traditional and ABS law firms) should have equivalent information irrespective of the kind of law firm used.

Figure 6: Consumer access to legal services via ABS and Introducers



- The situation is less clear in model B, where the consumer must be provided with information in relation to traditional law firms, but possibly not about referral payments in relation to ABS firms; this is because the referral payment for cases handled by ABS firms is paid by the owning entity not the law practice.
- Consumers using model D (an ABS introducer refers legal services to other firms paying referral fees) or models C and E, would not necessarily be provided with any information about the nature of the referral. This is due to model D being between lawyers, model E provides all services in-house, and model C is within a business group, so no actual referral payment occurs. The disclosure requirements would then apply to none of these arrangements. However, under model C there is a possibility that some companies might require 'transfer payments' (as accounting entries between otherwise separate entities) to be in place. This may mean that the situation is closer to Model A, and therefore a greater degree of transparency would be required.

7.14. An apparent outcome of ABS is that consumers could have significantly less information regarding referral fees and arrangements, depending on the business arrangement in place. Such reductions in transparency are worrying, especially as different functions within ABS firms could have competing interests - as, for example, if estate agents (acting for sellers) and conveyancers (acting for buyers) provided services under a single roof. This concern was echoed by the Royal Institution of Chartered Surveyors (RICS). In the experience of their members, consumers were not aware of the relationships between estate agencies and the

recommended conveyancing firm, and therefore would not understand the possible implications of a referral.

Implications of a ban

- 7.15. If a ban on paid referrals between lawyers and non-lawyers was introduced, then all law firms, including ABS, could no longer pay for cases referred by introducers. However, this does not mean that referrals, including paid referrals, could not continue if they were between lawyers.
- 7.16. With or without a ban, introducers may become ABS, or purchase a law firm, so that referrals could be provided either in-house or on a lawyer-to-lawyer basis. Assuming that lawyer-to-lawyer referrals remain permitted, this would result in referrals fees being paid legitimately, but without any requirements to inform consumers.
- 7.17. ABS could provide a number of alternative mechanisms to circumvent a ban. For example, it is not yet known whether the licensing rules for ABS could prevent an owning entity (that does not provide legal services) from paying referral fees to an introducer in order to have cases referred to its law firm (Model C in Figure 6). Equally, a law firm that is part of a business group, including introducers, could refer cases to a panel of law firms for a fee, as this would be a lawyer-to-lawyer referral. One major conveyancing firm acknowledged the likelihood of such an approach in the case of a ban:

"if all referral fee arrangements were to be banned excepting only those between lawyers, those estate agency chains which already own legal firms would find legitimate ways to continue to instruct their own law firms to act and under lawyer to lawyer exemption the option would remain for panelling from that in-house firm to external panel firms¹⁰⁷."

7.18. This approach already exists in reverse, and can cause problems in terms of disclosure (for example, a sub-contracted business may refer insurance claimants to a law firm, but the law firm pays referral fees to the insurance business direct, meaning that although the law firm still faces a requirement to disclose this arrangement, the introducer is under no such obligation).

7.19. In an ABS market, another key issue is the impact a referral fee ban would have on competition. In combining the introduction of ABS with a referral fee ban, there are two potential impacts:

- Traditional law firms may have to compete for a smaller share of the market, if large introducers become ABS and deal with more cases in-house or within the same business group. This could remove panels and reduce the range of firms to which cases are passed. Large referral organisations could establish business structures where they own a firm to whom they refer work as part of a single business group, rather than refer to external firms, as there will no longer be the financial incentive of referral fees. This could mean that little work from major introducers was passed to external law firms, both creating a larger pool of firms competing for non-referred work, and restricting to a smaller range the firms that consumers access through referrers.
- Those introducers who do not become ABS firms are likely to prefer ABS firms on their panel to non-ABS, as there is scope for an external owner (which does not provide legal services and thus unregulated in relation to referral arrangements) to pay referral fees in return for the introducer referring cases to its subsidiary law firm. In this case, the referral payments would be between two non-law businesses, and

therefore outside the scope of regulation (see model C in Figure 6). If choosing between a traditional law firm and an ABS-offered equivalent, the ABS is likely to be preferred if it was able to offer a financial incentive. It would mean the issues about how the size of referral fee dictates referral choice would continue, except it would be less transparent to consumers and not subject to regulatory scrutiny.

7.20. While the latter approach would clearly not be within the spirit of a ban, the loopholes which were exploited when referral fees were banned suggest that businesses would find novel routes around a ban.

Regulation

7.21. A key challenge is the risk of designing safeguards for problems that may not transpire. ABS firms will be subject to a wide range of regulatory requirements, including fitness to own and professional indemnity insurance requirements, which will provide checks and balances. As new entrants, household companies will not want to damage their brands by falling foul of regulators. This does not imply that risks are not present, but it may mean that the sensible approach is to monitor the market in the first instance, rather than to act pre-emptively. The legal services market is going to evolve over the next 5 years, and while a precautionary approach has merits in terms of protecting consumers from the outset, it comes with regulatory costs that could be passed onto consumers and create an unnecessarily onerous regulation that stifles innovation.

7.22. Regulators should take a two-fold approach to protecting consumers. First, licensing regimes need to be carefully designed to prevent conditions that could affect the independence of legal advice. Second, transparency would allow regulators to lift the veil on business arrangements, and alert consumers to

where they are being referred so that they can make informed decisions.

Summary of key points

- ABS could transform the shape of the legal services market. It is likely that some models – such as an introducer-owned law firm or a full multi-disciplinary practice – will remove the need for referral arrangements altogether.
- The key risk from ABS is that they may provide a mechanism for legitimate but less transparent referrals. Furthermore, it would be possible for law firms to obtain work as a result of the owning entity paying referral fees to an introducer as such arrangements would fall through the regulatory net.
- The scope for ABS to use lawyer-to-lawyer referrals as a means of circumventing regulatory requirements is another risk. Disclosure requirements should apply to all types of ABS.
- The licensing framework and economic incentives for ABS firms should have a positive impact on firm behaviour. Over-regulation could harm consumers by stifling innovation.
- Licensing rules be introduced to prevent conflicts of interest and ensure transparency.

8 Smarter Regulation

Introduction

- 8.1. Below we draw on the analysis in earlier sections of this report to discuss how regulation of referral arrangements could be made more effective. Action by the SRA has tackled some of the worst abuses of referral arrangements, but there are areas of concern and non-compliance with disclosure rules remains high among both solicitors and introducers.
- 8.2. In ending, we discuss whether it would be possible to enforce a ban on referral arrangements should this step be taken.

Problem - lack of data

- 8.3. A striking feature is the general lack of quantitative data, which makes it difficult to assess harm to consumers. The SRA and Claims Management Regulator annual data return exercises demonstrate the value of collecting information about firms.
- 8.4. This report has necessarily focused on solicitors as other legal regulators were unable to provide information about referral arrangements entered into by the firms they supervise. Regulators' ability to target areas of greatest risk depends on the quality of the intelligence at their disposal, but this information is missing outside of the solicitors' profession.

Solution – risk-based regulation

- 8.5. Regulators should close this knowledge gap so they are aware of referral activity. This will allow them to assess risks to consumers and intervene accordingly.

- 8.6. More broadly, a risk-based approach is needed. Referral arrangements can be entirely ethical and work in the consumer interest, but others compromise the independence of lawyers and are not in the best interests of clients. Equally, there are good lawyers and good introducers and bad lawyers and bad introducers.
- 8.7. The past six years of regulation, together with our analysis, identify where such arrangements pose greatest risk. For example, a risk-based approach would focus resources on firms which rely on referrals from a small number of introducers for a large proportion of their turnover, target areas where the incentives of introducers and consumers are not aligned, and would outlaw specific practices that harm consumers.

Problem – inconsistent regulation

- 8.8. The wide range of actors involved in referral arrangements are subject to different regulatory requirements. Where differently regulated legal professionals compete for work, as in conveyancing, such inconsistencies create an uneven playing field that could distort competition. A multiple set of rules is confusing and a burden for introducers to comply with – this affects consumers as it is likely to produce non-compliance. The regulatory maze is also difficult for consumers to understand.
- 8.9. There are instances of regulatory conflict. For example, the SRA prohibits solicitors from entering into referral arrangements with introducers who do not follow its disclosure rules (solicitors must ensure that introducers disclose referral fee

income). This means that estate agents are meant to inform buyers about referral fees, even though this is not required by their own regulations. It is difficult for solicitors to perform this policing role so it is unsurprising that non-compliance is rife.

Solution – joined-up regulation

- 8.10. There is common ground about the need for consistency in regulation. This becomes more pressing in the context of regulatory competition – which allows law firms to choose their regulator - as lawyers are likely to be attracted to the regime which imposes the least stringent requirements. Such incentives are unlikely to work in the consumer interest. The LSB must ensure a common floor of standards set at a level which protects consumers.
- 8.11. Joined-up regulation is needed so that everyone is following the same rules. There is a need for legal regulators and regulators outside of the sector to work together to develop a common framework of rules. The LSB is well-placed to hold the ring among legal regulators, but this process should also involve the FSA, OFT and the Claims Management Regulator.
- 8.12. This principle applies equally to Government Departments: at present, the Ministry of Justice is considering the Jackson Report recommending a ban on referral fees in personal injury while the Department for Business, Innovation and Skills is considering the OFT's report on referral fees in the estate agency market.
- 8.13. It is imperative that rules on referral arrangements bite on introducers as this is the point at which the lawyer is selected. Once engaged with a lawyer, financial and psychological barriers make it difficult for consumers to extract themselves. The absence of a dedicated sectoral regulator for estate agents makes this challenging.

Problem – exploiting loopholes

- 8.14. Practitioners complain that the current rules on referrals are complex and confusing. The SRA suggests that uncertainty in interpreting Rule 9 is a key reason for non-compliance¹⁰⁸. Irwin Mitchell highlighted how the rules have also been frequently changed, which only adds to the level of uncertainty¹⁰⁹.
- 8.15. Referral arrangements occur in different ways and with different participants. The diversity of arrangements can make it difficult for regulators to create a rule that covers all circumstances - a challenge that will increase with the introduction of Alternative Business Structures.
- 8.16. Complex rules-based regulation facilitates opportunities for firms to exploit loopholes. The ban on referral fees prior to 2004 was widely flouted as businesses entered into arrangements that involved referral fees in all but name. As regulators moved to close one loophole, firms changed their business practices to open another.

Solution – outcomes-based regulation

- 8.17. Outcomes-based regulation involves defining the end goals that the regime seeks to deliver and giving firms the freedom to organise their businesses to ensure such outcomes are achieved. The SRA is redesigning its regulatory regime along these lines.
- 8.18. A key benefit of outcomes-based regulation is flexibility: it is able to capture a much wider range of arrangements and deal with them in a risk-based way. This is important when regulating referral arrangements in an evolving market. Defining the desired outcomes from referral regulation, rather than trying to describe precisely which types of arrangements are permissible, should give consumers consistent protection and ensure regulation remains effective as the

market develops and innovates. In the context of ABS, these outcomes will need to apply to referrals between lawyers, as well as between lawyers and non-lawyers.

- 8.19. Some level of prescription is likely to be necessary within an outcomes-based regime. Detailed rules will be required when it is desirable for firms to behave consistently or when there are specific things that firms must not do. For example, mandatory disclosure requirements might be more effective if expressed as prescriptive rules so that consumers can compare like with like.

Problem - low transparency

- 8.20. Existing rules should provide for high levels of transparency as both introducers and solicitors must disclose when a referral arrangement takes place and the size of any referral fee. This is undermined by weaker disclosure regimes affecting other lawyers and some introducers.
- 8.21. However, non-compliance with disclosure rules has been rife. In 2007, up to two-thirds of firms inspected by the SRA were not compliant with its Rule 9. For example, 43.2% failed to disclose to clients its financial arrangements with its introducers, 58.9% failed to obtain an undertaking from its introducers that they will comply with SRA rules and 66.4% failed to give clients a statement that they could raise questions on all aspects of the transaction¹¹⁰.
- 8.22. Poor compliance with disclosure rules is not surprising given the impact that revelation of the referral might have on consumer behaviour. Across the economy, businesses often comply with disclosure rules in a way that suits their purposes, rather than communicate the information in a format that facilitates the intended outcomes for consumers, for example by hiding key terms in small print¹¹¹.

Solution – an effectively enforced transparency regime

- 8.23. Transparency should remain the main focus of regulatory requirements. Consumers participating in our research were suspicious of referral arrangements, but the promise of transparency eased their concerns. Disclosure of the referral relationship alerts consumers to the possibility of conflict, counters pressure selling, encourages consumers to compare prices to find the best deal and helps regulators to monitor the market.
- 8.24. However, transparency is not a panacea. First, it might provide false comfort as consumers may lack the expertise to know whether there is a potential conflict of interest. Furthermore, consumers commonly claim they will shop around to compare prices, but often do not follow through on these good intentions.
- 8.25. The high level of non-compliance with disclosure rules in conveyancing suggests that further action is required. One option is to require consumers to give their written consent to the referral – such a form could also outline the potential risks of conflicts. This would alert consumers to the pitfalls, prompt them to shop around and provide an audit trail for regulators to monitor compliance. However, it is possible to foresee problems with this approach: consumers might sign the form without reading it; or it could introduce delay if a consumer wanted to take the form away before signing. Clearly, the benefits and risks of unintended consequences would need careful thinking-through. However, the existing regime is not sufficient on its own to ensure a transparent market.
- 8.26. Finally, echoing our comments about joined-up regulation, a consistent set of disclosure rules is needed. There should be no exemptions for not-for-profit bodies as the risk of conflict remains and clients have a right to know about the terms of a

referral involving them. Furthermore, disclosure rules must be backed up by tough sanctions for those who transgress. In particular, the penalties should serve as a strong deterrent.

Could the genie be put back in the bottle?

- 8.27. Should decision-makers decide to ban referral arrangements, would this be possible in practice?
- 8.28. The ban on referral fees prior to 2004 was followed more in breach than in the observance. Referral fees are the lifeblood of claims management companies and represent a significant income stream for other introducers. These businesses would not simply accept a ban and move on. Indeed, introducers described how they would seek to circumvent a ban – coming up with list of credible methods. These business arrangements would be less

transparent - and harder to monitor - than if they were conducted in the open.

- 8.29. More significantly, it would be difficult to ban referral arrangements in an ABS world without distorting competition. The need to enter into referral arrangements disappears should introducers and lawyers become part of the same business. Prohibiting referral arrangements would make it more difficult for traditional law firms to compete with these new arrivals.
- 8.30. However, while enforcing a ban on referral arrangements would be difficult and expensive, it would not be impossible. In particular, the shift towards outcomes-focused regulation would allow regulators to target business arrangements that fall foul of the spirit of the rules. The FSA's decision to end commission payments on investment products and to amend its guidance on inducements proves that regulators can act boldly to change fundamentally the way a market operates.

Summary of key points

- The lack of quantitative data makes it difficult to assess harm to consumers. Regulators should regularly collect information on referral arrangements in order to inform a risk-based approach.
- There is inconsistent regulation reflected in different sets of rules enforced by legal regulators and regulators of introducers. Regulators should co-operate to develop a common framework of rules biting on lawyers and introducers.
- Practitioners complain about a complex and confusing set of rules, while firms have successfully exploited loopholes in prescriptive regimes. An outcomes-based approach is better placed to deal with the wide variety of referral arrangements and keep pace with market developments.
- Non-compliance with transparency rules is rife. Transparency should continue to be a key feature of the regulatory regime, but its limitations need to be understood and the rules need to be backed up with sanctions that exceed the gains of mischief.
- A ban on referral arrangements, if desirable, would be difficult and expensive to enforce, but not impossible.

9 The Panel's verdict

Would a ban on referral arrangements be in the consumer interest?

- 9.1. The Consumer Panel wants a market where everyone can access high quality and affordable legal services that meet their needs. An evidence-based approach has been taken to assess the impact of referral arrangements on consumers.

Serious charges to answer

- 9.2. The charges levelled at referral arrangements are serious: it is argued that they compromise the independence of legal advice, and lead to more expensive or poorer quality service. However, in both conveyancing and personal injury, the evidence does not substantiate these concerns. Instead, there are high levels of satisfaction with outcomes and service regardless of the way in which lawyers are chosen, and conveyancing prices are actually cheaper among law firms paying referral fees. Breaches of independence rules are rare. Indeed, the risks of conflict in the personal injury market result from the way in which lawyers are remunerated, not from referral fees. Referral fees might exacerbate such effects, but they are not the root cause. It follows that such market imperfections should be treated at source.

Access to justice a key benefit of referred work in the personal injury market

- 9.3. Referral arrangements deliver one real benefit for consumers: marketing and the hand-holding role performed by claims management companies and not-for-profit bodies have helped people to achieve redress. While people who suffer the most

serious injuries are already intent on making a claim, claims management companies persuade those with less severe injuries to pursue compensation. Nevertheless, the high success rates in RTA claims suggests this is not fuelling a compensation culture.

Problems to tackle

- 9.4. Therefore, a ban on referral arrangements would not be in the consumer interest. However, this investigation has exposed a series of practices which cause, or have the potential to cause, harm to consumers. The Panel's view that referral arrangements should remain permitted is conditional on concrete action being taken to tackle the following concerns:
- Work being referred to the law firm paying the highest referral fee, rather than an objective recommendation of which provider would best meet the client's needs – this increases the size of referral fees and could mean that consumers are referred to more expensive or unsuitable law firms.
 - Pressure selling - by estate agents to use their recommended lawyer, as well as cold-calling by claims management companies - remains a problem. Furthermore, the controversy over whether BTE insurers should be able to nominate a lawyer needs resolution.
 - Persistent non compliance with disclosure rules by both lawyers and estate agents. Further steps to improve transparency, including a requirement to obtain the client's written consent to the referral, should be considered.

- Asking solicitors to police introducer compliance with the SRA's rules is unrealistic, but the absence of a dedicated regulator for estate agents creates an enforcement gap.
- The increasing amount of legal work allocated via introducer panels raises competition concerns - there is little change in panel membership and the entry requirements limit access for smaller firms.

Recommendations

The Panel's advice to the LSB is as follows:

- Referral arrangements should continue to be permitted, but the LSB should review the market in three years time.
- The LSB should lead a collaborative initiative to achieve a consistent set of regulatory requirements within and outside the legal sector.
- The LSB should monitor through surveys the impact of referral arrangements on levels of client satisfaction with outcomes and service.
- The LSB should consider further measures to improve transparency to place the consumer at the heart of referral transactions. This could include obtaining a client's written consent for referred conveyancing work.
- Approved Regulators should systematically collect data on referral arrangements.
- Approved Regulators should consider prohibiting firms from entering into bidding auctions or similar processes for referred work.
- Approved Regulators should issue guidance on the circumstances under which a dependency on referral arrangements creates a risk of conflict.
- Licensing Authorities should introduce disclosure rules for all types of ABS.
- The OFT should consider investigating whether competition in relation to introducer panels is working effectively.
- The OFT should provide guidance on the likely application of general consumer law to referral arrangements.
- The OFT, with its partners in trading standards, should carry out mystery shopping of pressure selling by estate agents and, if necessary, take enforcement action.
- Business acquisition costs should be openly factored into the calculation of fixed fee regimes (developed by the Ministry of Justice) and Guideline Hourly Rates (set by the Master of the Rolls).

Annex 1 – Terms of Reference

Investigation Scope

The Consumer Panel is defining referral arrangements as any arrangement under which business is received from, or referred to, a third party. In the legal services sector, the third party may be another lawyer, but it may also involve introducers such as claims management companies, insurance companies and estate agents. Referral arrangements are often characterised by payment in return for referral of business, but fees do not need to be involved.

The Consumer Panel will be examining the use of referral arrangements by authorised persons across the whole legal profession, although we will prioritise areas that have the greatest consumer impact. In considering different types of referral arrangements, the Panel will be looking at both the payment and the receipt of referral fees by lawyers under a number of different models, as well as non-monetary arrangements that are linked to the introduction of clients, such as the provision of free or below-cost services in exchange for the referral of other business.

Keys Areas of Investigation

The Panel is specifically seeking views and evidence from stakeholders on the following topics:

a) Demonstrable positive and negative outcomes for consumers due to referral arrangements, such as the impact on

access to justice, consumer choice of lawyer, quality of legal advice and independence of legal advice.

b) Feasibility and effectiveness of possible consumer safeguards, such as consumer education, disclosure, consent, standardised referral agreements or a cap on referral fees.

c) The role of referral arrangements in driving or inhibiting competition in the legal services market.

d) Degree to which referral fee size reflects equivalent marketing/other costs.

e) Feasibility and effectiveness of alternatives to referral fees as a means of obtaining work, such as direct advertising by law firms, the establishment of legal firm marketing alliances, non-paid referral networks and/or quality assurance schemes.

f) Risks and benefits for different stakeholders of a reintroduced ban on referral fees, including consumers, the legal profession, and non-legal stakeholders, such as claims management companies.

g) Relevant parallels with referral and commission arrangements used in other sectors in relation to customer introduction.

We would also appreciate information on any other areas that we have not included, but which you consider would be relevant to our investigation.

Annex 2 – Contributors

We are grateful to the following individuals and organisations who contributed to our investigation:

Allianz

Abbey Legal Protection

Accident Line

Amelans Solicitors

APIL

Association of British Insurers

Association of Home Information Pack Providers

Aviva

Bar Council

Bar Council's Young Barristers' Committee

Bar Standards Board

Richard Barnett

Blacks Solicitors LLP

Brethertons LLP

Browne Jacobson LLP

Professor Richard Moorhead, Cardiff Law School

Christopher Kinch QC

City of London Law Society

Civil Justice Council

Claims Management Regulator

Claims Standards Council

Council for Licensed Conveyancers

Connells

Contact Law

Co-Operative Legal Services

Council of the Inns of Court

Countrywide Conveyancing division

Direct Conveyancing Association
Durows, Martin and Company
Epoq Group
Federation of Property Information Partners
Forum of Insurance Lawyers
G W Choat & Co, Solicitors
Hampshire Law Society
Horwich Farrelly Solicitors
ILEX Professional Standards Ltd
Inesons Solicitors
Institute of Professional Willwriters
Inter-resolve
Irwin Mitchell
Law Society - Property Section
LawNet Limited
LawPack
Legal Complaints Service
Legal Marketing Services
Legal Services Commission
Legal Services Commission
Professor Stephen Mayson, Legal Services Institute
Lewis Hymanson Small Solicitors LLP
Minster Law Solicitors
Motor Accident Solicitors Society
National Accident Helpline
National Federation of Property Professionals
NHS Litigation Authority
Nick Gurney-Champion
Office of Fair Trading
Open Convey
Premier Property Lawyers
Quality Solicitors
Reddie & Grose
Roger Sheriff

Royal Institution of Chartered Surveyors
Shoosmiths
Solicitor Sole Practitioners Group
Solicitors Regulation Authority
Solicitors Sole Practitioners Group
The Association of Personal Injury Lawyers
The Bold Group
The Council for Licensed Conveyancers
The General Council of the Bar
The Law Society
The Legal Alliance
The Property Ombudsman
Thompsons Solicitors
Thornycroft Solicitors
Tinklin Springall Solicitors
Trades Union Congress
Unison
Unite
USDAW
Wall James Chappell
Waller and Hart
Which?
Wilkin Chapman LLP
Zurich

Annex 3 – Regulatory requirements

Lawyers

Authorised Person	Regulating body	Permissibility of Referral Arrangements	Requirements placed on Authorised Person
Solicitor	SRA	<ul style="list-style-type: none"> ▪ Referral arrangements between lawyers and non-lawyers permitted ▪ Referral arrangements between lawyers permitted 	<ul style="list-style-type: none"> ▪ Rule 9 of the SRA Code of Conduct places a number of requirements on solicitors making or receiving business referrals from third-party non-lawyers, including: <ul style="list-style-type: none"> ○ solicitors must do nothing which would compromise your independence or your ability to act and advise in the best interests of your clients; ○ there must be written agreement where financial payments are made for the referrals; ○ the written agreement must require the introducer to disclose to the client if they have a financial arrangement with the introducer and the amount of the payment; and ○ solicitors must disclose to clients in writing if they have a financial arrangement with the introducer and the amount of the payment. ▪ There is no specific requirements relating to referrals between lawyers and Rule 9 explicitly excludes lawyer to lawyer referrals.
Barrister	BSB	<ul style="list-style-type: none"> ▪ Referral fees not permitted 	<ul style="list-style-type: none"> ▪ Referral fees banned under Rule 307 of the Code of Conduct.

			<ul style="list-style-type: none"> ▪ The only exception is that public access barristers can pay to advertise on a website, provided potential clients generated by the website contact the barrister directly. ▪ Clients can also pay a company to be introduced to a public access barrister, provided no money changes hands between the public access barrister and the referral company.
Conveyancer	CLC	<ul style="list-style-type: none"> ▪ Referral arrangements (payment and receipt) permitted. 	<ul style="list-style-type: none"> ▪ Rule 5.2 of the CLC Conduct Rules requires that a licensed conveyancer must disclose to a Client in writing, as soon as they are known to the Licensed Conveyancer, the existence and amount of any sum payable by or to the Licensed Conveyancer arising, whether directly or indirectly, from the Client's instructions. ▪ Guidance 6 states that when accepting instructions a client must be informed in writing of: <ul style="list-style-type: none"> ○ any referral arrangement and any sum paid in connection with the introduction, or, if that is not practicable, the maximum sum which may be paid; and ○ any arrangement where the licensed conveyancer is to introduce the Client to another person, and any sum to be paid in connection with that introduction, or, if it is not practicable to inform the Client of the exact sum, the maximum sum which may be paid.
Legal Executive	ILEX Professional Standards	<ul style="list-style-type: none"> ▪ Referral fees permitted. 	<ul style="list-style-type: none"> ▪ Subject to compliance with SRA rules on this matter (see above)
Trade Mark and Patent attorney's	IPREG	<ul style="list-style-type: none"> ▪ Referrals fees are permitted by omission 	<ul style="list-style-type: none"> ▪ There are no specific rules or guidance about referrals/introductions in the Code of Conduct that explicitly allow or ban referral arrangements.
Law Cost Draftsmen	ALCD	<ul style="list-style-type: none"> ▪ Referral fees permitted by omission ▪ 	<ul style="list-style-type: none"> ▪ There are no specific rules or guidance about referrals/introductions in the Code of Conduct that explicitly allow or ban referral arrangements. ▪ ALCD has advised that "To date there has been no restriction upon the basis of charging structure of the membership owing to the fact that this was considered to

			<ul style="list-style-type: none"> ▪ reflect restrictive practice”
Notaries	Faculty Office	<ul style="list-style-type: none"> ▪ Referral fees permitted 	<ul style="list-style-type: none"> ▪ Practice Rule 13 requires that a notary entering into arrangements for the making or receiving of client referrals must ensure that: <ul style="list-style-type: none"> ○ the client is informed in writing of the arrangement and of any commission or other benefit the notary may be receiving or pay; ○ the client agrees in writing to the destination of the commission or the notary accounts the commission to the client; and ○ he remains able to advise the client independently in accordance with these rules and continues to do so regardless of his own interests.

Introducers

Type of Introducer	Regulating body (if any)	Permissibility of Referral Arrangements	Requirements placed on Introducer
Claims Management Company	Claims Management Regulator	Allowed	<ul style="list-style-type: none"> ▪ Clause 8 of the Conduct of Authorised Persons Rules requires that where business is introduced to a solicitor, the business must not act in a way that puts the solicitor in breach of the rules governing solicitors’ conduct. ▪ Clause 11 requires that if a CMC has a contractual relationship with a client, then prior to the contract being agreed it must provide in writing or electronically information about: <ul style="list-style-type: none"> ○ Any referral fee paid to, or other financial arrangement with, any other person in respect of introducing the claim. ○ Any relationship to a particular solicitor or panel of solicitors.

Estate Agents	Estate agents must be part of an OFT approved redress scheme – either the Property Ombudsman or the Surveyors Ombudsman Service Specific statutory requirements also apply.	Allowed	<ul style="list-style-type: none"> ▪ The Estate Agents (Provision of Information) Regulations 1991 requires that estate agent must tell a seller in writing, before agreeing to act, of services (including insurance and financial assistance) which a third party may offer in cases where the estate agent would derive a financial benefit, including commission or any performance related benefit. There is no equivalent requirement for buyers.
Panel Managers	None	Allowed	None
Insurers and insurance intermediaries	Financial Services Authority	Allowed	<ul style="list-style-type: none"> ▪ Whilst there are a range of requirements placed on insurance intermediaries in relation to commission payments from an insurer, there appears to be no specific requirements relating to the receipt of referral payments from legal service providers.
Banks and mortgage brokers	Financial Services Authority	Allowed	<ul style="list-style-type: none"> ▪ Whilst there are a range of requirements placed on banks and mortgage brokers in relation to commission payments from an insurer, there appears to be no specific requirements relating to other referral payments.
Trade Unions		Allowed	<ul style="list-style-type: none"> ▪ The Compensation (Exemptions) Order 2006 exempts independent Trade Unions from needing to be authorised under the Compensation Act 2006 in respect of services provided to their own members (or retired members). This exemption is granted on condition that Trade Unions act in accordance with the Code of Practice for the provision of Regulated Claims Management Services by Trade Unions. ▪ Clauses 2 and 3 of the Code of Practice state that: <ul style="list-style-type: none"> ○ any referral fees received by the Trade Union in respect of the member's claim should be disclosed. ○ a member should be informed of any relationship between the Trade Union and any third party (including a solicitor, claims management company or any other agency) where such a relationship has a direct bearing on the handling of a claim on behalf of a member;

			<ul style="list-style-type: none">○ the involvement of any subsidiary companies in handling a member's claims (whether owned wholly or partly by the Trade Union) should be disclosed.○ all information given by a Trade Union to a member about arrangements with third parties should be clear and appropriate to the members needs. Trade Unions do not need to disclose commercially sensitive information. Commercially sensitive information does not include a referral fee received by a trade union.
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Annex 4 – Funding of personal injury claims

Personal injury claims valued at under £1,000 may be heard in the small claims court. Claims valued between £1,000-£25,000 are heard in the fast track, with claims above this in the multi-track.

Conditional fee agreements

Personal injury claims are not eligible for legal aid support. Conditional fee agreements (CFAs) filled this gap by enabling lawyers to be remunerated on a “no win no fee” basis. If the lawyer wins, he may recover a “success fee” – an increase in the normal level of fees the lawyer charges. The maximum success fee permitted is 100% (to reflect the risk of losing half of cases). Success fees are recoverable from the losing side, enabling clients to recover 100% of damages.

Collective conditional fee agreements (CCFAs) allow a bulk purchaser to enter into a CFA agreement but at a prearranged success fee.

Legal expenses insurance

Legal expenses insurance policies insure consumers against claims that may be made against them and for claims they make against others. So-called before-the-event (BTE) insurance is normally purchased as an add-on to household and motor policies. Insurers will refer the case to one of their panel solicitors in return for a referral fee. As they pass regular work to panel solicitors, insurers negotiate the

rates that these solicitors charge, normally on an hourly rate basis. The vast majority of claims are successful; either solicitors or insurers pay costs in those few lost cases in the fast or multi-track.

Lord Justice Jackson made a distinction between two types of BTE cover:

- Where insurers pay solicitors to act for the insured when a claim arises
- Where insurers will “sell” to solicitors claims which arise in return for referral fees and the solicitors will thereafter act on a CFA or CCFA (in which cases the insurer does not pay the solicitor’s fees)

After-the-event insurance

After-the-event (ATE) insurance covers a litigant against future liability for the costs of an opposing party. It is taken out by claimants far more often than defendants. Sometimes ATE insurance covers other costs risks, such as liability for own counsel’s fees, expert fees, court fees or other disbursements (in the event that they are not recovered from the other side). The use of ATE expanded significantly after a rule change in 2000 that permitted the winning party to recover the ATE premium as a disbursement. In the majority of cases the ATE premium is itself a disbursement covered by the policy. In other words, the insured does not have to pay the premium if he loses. If he wins, the insured is liable

for the premium, but will seek to recover it under any order for costs.

Contingency fees

Contingency fees are payable if the client wins and are calculated as a percentage of the sum recovered from the losing party. Solicitors are not permitted to act on contingency fees for contentious work. However, proceedings in all tribunals other than the Lands Tribunal and the Employment Appeal Tribunal are classified as “non-contentious” business and so solicitors may conduct tribunal proceedings on the basis of contingency fees.

Fixed costs

In fixed costs regimes, rules specify the amount in solicitor’s charges that may be recovered from one party by another in respect of costs in certain circumstances. The fixed costs relate to four elements: the commencement of a claim, costs on the entry of a judgment; enforcement costs; and court fees.

RTA claims - before 30 April 2010

A fixed costs regime applies to Road Traffic Accident (RTA) claims under £10,000. The costs that may be recovered include three elements: base costs calculated at £800 plus 20% of the agreed damages up to £5,000 and 15% of the

agreed damages between £5,000-£10,000; specified disbursements; and success fees where a CFA is taken out (capped at 12.5% of base costs).

RTA claims - after 30 April 2010

A new three-stage regime for RTA claims under £10,000 was introduced on 30 April 2010 with fixed costs agreed following a mediation process.

- Stage 1 – notification to defendants and insurers (fixed recoverable costs of £400 where liability is admitted plus a 12.5% success fee where a CFA is in place, although this is only payable at the end of Stage 2 where the case settles)
- Stage 2 – medical evidence, offers to settle and negotiation (fixed recoverable costs of £800 plus a 12.5% success fee as above)
- Stage 3 – where quantum cannot be agreed (separate fixed recoverable costs for paper (£250) and oral hearings (£500) plus a success fee of 100% where a CFA is in place and the claim concludes at trial and the claimant has won. Where settlement is reached between the issue of the claim and before the trial commences, fixed recoverable costs of £250 will apply plus a success fee of 12.5% where there is a CFA in place.

Annex 5 – Natcen Analysis

Agree/disagree with the following statement	Answer	Word of mouth or through family/friends	Had used provider before/family's provider	Referral by another organisation	Other answers
Satisfaction with outcome	Very satisfied	73.5%	75.6%	68.2%	69.2%
	Quite satisfied	20.0%	18.2%	22.9%	21.0%
	Not very satisfied	2.6%	4.5%	3.4%	5.1%
	Not at all satisfied	3.9%	1.7%	5.6%	4.6%
Provider provided a good service	Agree	91.9%	93.1%	91.5%	88.3%
	Disagree	5.9%	5.1%	7.0%	10.0%
	Not applicable	0.0%	0.5%	0.0%	0.0%
	Neither agree nor disagree	2.2%	1.4%	1.4%	1.7%
Main contact answered calls/letters promptly	Agree	88.6%	92.6%	88.7%	85.3%
	Disagree	8.5%	6.0%	8.9%	8.7%
	Not applicable	2.6%	1.4%	5.2%	5.2%
	Neither agree nor disagree	0.4%	0.0%	0.9%	0.9%
Main contact acts/acted in a professional manner	Agree	97.0%	96.3%	93.9%	95.3%
	Disagree	2.6%	2.3%	5.2%	4.8%
	Not applicable	0.0%	0.0%	0.5%	0.0%
	Neither agree nor disagree	0.4%	1.4%	0.5%	1.7%
Contact explained things in a way could understand	Agree	96.0%	97.2%	95.8%	95.7%
	Disagree	2.6%	2.3%	2.3%	2.6%
	Not applicable	0.7%	0.0%	0.5%	0.4%
	Neither agree nor disagree	0.7%	0.5%	1.4%	1.3%
Main contact is/was approachable	Agree	95.6%	97.2%	91.5%	92.6%
	Disagree	3.3%	1.8%	6.1%	5.2%
	Not applicable	0.4%	0.0%	0.9%	0.4%

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	Neither agree nor disagree	0.7%	0.9%	1.4%	1.7%
Contact knew what was going on in matter	Agree	96.3%	97.2%	90.6%	92.2%
	Disagree	3.3%	1.4%	7.5%	7.0%
	Not applicable	0.0%	0.0%	0.5%	0.0%
	Neither agree nor disagree	0.4%	1.4%	1.4%	0.9%
Provider was acting in best interests	Agree	91.9%	94.5%	92.0%	90.5%
	Disagree	5.2%	3.2%	5.2%	5.6%
	Not applicable	0.4%	0.0%	0.5%	0.9%
	Neither agree nor disagree	2.6%	2.3%	2.3%	3.0%

Notes

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The Legal Services Consumer Panel was established under the Legal Services Act 2007 to provide independent advice to the Legal Services Board about the interests of consumers of legal services in England and Wales. We investigate issues that affect consumers and use this information to influence decisions about the regulation of legal services.

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