

BAR
STANDARDS
BOARD

REGULATING BARRISTERS

Chris Kenny
Legal Services Board
7th Floor
Victoria House
Southampton Row
London
WC1B 4AD

17 December 2010

Dear Chris,

Re: LSB Referral Fees Discussion Document

Please find enclosed the BSB's response to the LSB referral fees discussion document.

We welcome the opportunity to respond to the discussion document. However, we are concerned that by focussing narrowly on "referral fees" as defined, insufficient attention is being paid to the detriment to consumers and to competition that can arise from lawyer to lawyer referrals and introductions whether or not as a result of the payment of "referral fees". This detriment has also been overshadowed to an unacceptable extent by the focus on referral fees paid by lawyers to non-lawyers. There is no read across from one to the other here – the risks to the regulatory objectives created by lawyer to lawyer referrals are of a different nature and require discrete attention.

Reliance on disclosure and the competence of a lawyer to whom business is referred as sufficient to address risks arising from referrals by non-lawyers is based, in our view, on inadequate analysis and goes nowhere near in practice or in law to mitigating those risks sufficiently. Nor would it go far enough to meet the statutory objective of delivering legal services which serve the *best* needs of consumers. It will be even less effective in addressing the identified mischiefs in lawyer to lawyer arrangements.

Although we share the objective of basing regulatory policy on evidence of customer detriment, we do not agree with the assumption that where there is no quantifiable evidence of systematic detriment that proves that there is no such detriment. There is well publicised evidence of the most severe detriment arising from non-lawyer to lawyer referrals, namely the behaviour of some solicitors' firms who were reprimanded by the Solicitors' Regulation Authority for their conduct in handling compensation claims for miners for industrial disease. This serves as a good example of where the influence of referral fees has led to a lack of

compliance/ failure to adhere to regulatory objectives which has had a devastating impact on large numbers of individuals, and justice more generally. Given that solicitors were party to the mischiefs in such cases we see no grounds for assuming that lawyer to lawyer business will not be subject to similar abuse unless forestalled effectively by regulatory action.

Although our focus in our submission and in this letter is on lawyer to lawyer arrangements for the reasons set out in the annex to our full submission we do not consider that either of the reports that inform the discussion document used an adequate evidence base to determine the impact of referral arrangements.

For example, in the CRA Report, only 2 barristers were interviewed as part of a group of 10 people in total about criminal advocacy (see page 9 of CRA Report). The general lack of data available is highlighted in Chapter 8 (8.3) of the Consumer Panel report which states that: "A striking feature is the general lack of quantitative data, which makes it difficult to assess harm to consumers", and (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".

In addition, both of the reports largely ignore Sir Rupert Jackson's report on costs.¹

Whilst there was a substantial amount of evidence submitted to the Jackson report, neither report acknowledges the use of any of this evidence. Reference is made in the Consumer Panel report that Jackson recommended a ban of referral fees in personal injury cases, but this is not given sufficient weight in the recommendations in the discussion document. We believe that the lack of a proper evidence base (both quantitative and qualitative) and the fact that this has meant the impact on advocacy has been excluded entirely from the Consumer Panel report, and only covered superficially in the CRA report, demonstrates that a conclusion cannot be drawn about the true impact of referral fees on the provision of legal services.

I would draw your attention also to the argument in our submission relating to Rule 5.4 of the Council of Bar and Law Societies of Europe Code of Conduct. This rule exists to ensure that lawyer do not pay or receive payments purely for the reference of a client, because this would risk impairing the customer's free choice of lawyer or the customer's interest in being referred to the best available service. Permitting referral fees in the UK could have a detrimental impact on European cross border activities, and thought should be given as to how this could impact on the ABS regime when it is introduced.


Finally, you will know of our concern that the LSB has not recognised the implications of the non disclosure of relevant conflicts of interest in the report by the LSB Consumer Panel on referral fees

You will note that we have not suggested what should replace the proposals in your discussion document. That is because, as we have suggested previously, we had hoped that the LSB might want to take the lead in co-ordinating a cross- approved regulator

¹ <http://www.judiciary.gov.uk/NR/rdonlyres/8EB9F3F3-9C4A-4139-8A93-56F09672EB6A/0/jacksonfinalreport140110.pdf>

approach to this legal services market-wide issue – an issue which in our view tests the system's ability to deliver the regulatory principles. At the very least, I hope you accept that there is a need to go further than you have done to date to satisfy yourself that the system will in respect of arrangements between lawyers (and we would argue in respect of all referral arrangements) deliver legal services which serve customers' best interests.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ruth Deech', written in a cursive style.

Baroness Ruth Deech
Chair, Bar Standards Board

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REGULATING BARRISTERS

BSB response to LSB Referral Fees Discussion Document

1 Overview

- 1.1 We welcome the increased profile given to risks to lay customers inherent in biased lawyer- to-lawyer referrals, an issue which has largely taken a back seat to referrals to lawyers by non-lawyers.
- 1.2 We also welcome the LSB's recognition that the potential for bias in lawyer-to-lawyer referrals does not arise solely from referral fees but from a range of above and below the line financial and non-financial arrangements and understandings between lawyers the *raison d'être* of which is to influence the selection of provider of specialist advice or higher court advocacy services.
- 1.3 However, we disagree with the LSB in that –
- We do not agree that the conflicts of interest and potential for bias created by financial and other inducements between lawyers can or should be managed simply through factual disclosure to customers of those inducements and through referrals being to a lawyer who is competent and nothing more;
 - We do not think that it can safely be assumed that there is no systematic customer detriment arising from lawyer to lawyer referrals;
 - We do not believe that monitoring by approved regulators can be sufficiently effective in closing the gap between what is seen as sufficient to meet customers' best interests, and the scope for customer detriment which we believe is left unaddressed by the proposals in the Discussion Paper.
- 1.4 As with our earlier submissions, our aim is not to protect the competitiveness of any players in the legal services market, but to ensure that self-interest and bias do not cut across what matters most to customers – i.e. that they are dealing with threats to their personal and financial well-being with the assistance of the lawyer they are justifiably confident is right for them.
- 1.5 We think also that the LSB and approved regulators need to consider the extent to which, and the circumstances in which an arrangement or understanding between a referring and a recipient lawyer might be regarded under the Bribery Act 2010 as constituting “a financial or other advantage” offered, promised, or given to the referring lawyer as an inducement to that lawyer not to act impartially or act in good faith, in breach of the referring lawyer's regulatory requirements. It seems to us that payments in

cash or in kind by one lawyer to another lawyer, who owes a fiduciary duty to his client, are calculated to influence that lawyer's decision making on behalf of his client, and so may well be such an "inducement."

2 The variety of financial arrangements underpinning lawyer to lawyer referrals

2.1 Where a lawyer's customer requires specialist advice or higher court advocacy services that lawyer can select or recommend one of the following providers of these –

(In some cases) a partner or employee in the same firm – in which event the referring lawyer will benefit directly or indirectly from the referral and indeed may even be targeted or rewarded on a bonus or commissions-type basis for internal referrals.

Such referrals may seem entirely logical and acceptable to lay customers. But for their acceptance to be informed they would need to be aware that there are other possible – and possibly better-suited – providers outside the referring lawyer's firm, and the referring lawyer should not falsely represent the in-house provider as best placed across all providers to meet the customer's best interests. There is a parallel in this respect with financial services regulation where a key requirement of financial advisers is that they disclose any limitations on their recommendations of product or service provider.

An employed barrister, or solicitor with Higher Court Advocacy rights, employed elsewhere – in which event the referring lawyer can require or receive a share of the recipient lawyer's fees, a straightforward fee, and/or a range of benefits in kind or reciprocal arrangements.

Unlike in-house referrals, there is a very real risk here of customers trusting the referring lawyer to have selected an external lawyer on merit alone. The legal services regulatory framework should ensure that such assumptions are dispelled where they are misplaced.

A member of the independent bar – in which event the referring solicitor gains no financial benefit from the referral.

2.2 The acid test of regulatory effectiveness in all these cases is that it ensures that the referring lawyer is serving the customer's "best" interests given in particular their self-evident conflict of interest when selecting either of the first two options in preference to the third.

2.3 For the reasons given below, we do not share the LSB's confidence that (i) disclosure to the customer of the advantage gained by the referring lawyer; (ii) the competence of the recipient; and (iii) enforcement by approved regulators, are capable of providing separately or in aggregate sufficient comfort either that a lawyer making a referral has resolved the conflict in the "best interests" of the customer; or that the customer or the regulator will for the most part be able to detect instances where those interests have not been served.

(i) Disclosure offers limited benefits

2.4 There is, clearly, an important place in the regulatory apparatus for meaningful and effective disclosure as an aid to addressing bias and conflicts of interest. But it is only an aid and not the complete answer. Indeed we would have thought that professionals with a fiduciary duty to their clients ought not properly put themselves in a position where that duty conflicts with their own interests. That obligation is reflected in so far as solicitors are concerned under Rule 3.01 (2) (b) of the SRA's Code of Conduct which requires that solicitors -

“... must not act if their duty to act in the best interests of any client in relation to a matter conflicts, or there is a significant risk that it may conflict, with [their] own interests in relation to that or a related matter”

2.5 If it were to be argued that the SRA Code does not bear that interpretation we would not readily accept the argument that solicitors can place themselves in a position of conflict provided they disclose their self-interest. At the least the client should consent to the solicitor's acting in the face of the conflict (and to his retaining rather than disbursing any payments received). Moreover, mere consent is insufficient, that consent needs to be properly informed which requires that the customer received additional information on the lines we suggest in paragraph 2.6 below.

2.6 Even in a regime of proper disclosure to secure a client's informed consent, it ought not to be open to a regulator to take a back seat by placing responsibility on customers to identify conflicts of interest and/or to challenge the recipient to demonstrate how that conflict has been resolved in their favour. Regulators still have an interest in ensuring that conflicts of interest are avoided, or at the least resolved in the customer's best interests.

2.7 To the extent that disclosure can act as an aid, it would, for the reasons given below, need to go further than merely informing the customer of the advantage the referring lawyer stands to gain from a referral -

- ***The fact that the referring lawyer has disclosed the fact that he will benefit in one way or another from a referral does not say anything about whether or not they acted impartially and in the best interests of the customer;***

We do not accept the logic of the argument that making customers aware that a provider is being recommended in return for a fee or other consideration, will thereby equip them to make an informed decision about who is best to assist them with their particular needs.

Few customers can make an informed choice of lawyer to provide even straightforward “best buy” types of commoditised legal services such as conveyancing. The number of customers able to make an informed choice of provider of specialist advice or advocacy services will be even fewer – whether or not they have been told of the referring lawyer's interest. They will, quite correctly, trust the selection by the referring lawyer and should not be required to

take on the onus of linking the advantage to the referring lawyer to the suitability of the lawyer to whom they have been referred.

- ***At practical level, not all arrangements between a referring and a recipient lawyer will be or are even capable of being explained clearly, fairly, and intelligibly, particularly to the unsophisticated and vulnerable;***

It is naïve to think that all referral arrangements will be in the simple form of £x or x% of the recipient's fees. Experience elsewhere suggests that –

Arrangements will be devised which are complex, incapable of short disclosure or even of being disclosed in quantifiable form – e.g. that the amount the recipient lawyer pays will be on a sliding volume-related scale with retrospective effect;

The clarity of the disclosure will be obfuscated through the referring lawyer's giving an ad absurdum list of "benefits" arising from the relationship with the recipient lawyer so as to ridicule the concept of disclosure and deter the customer from spotting what is meaningful in amongst what is absurd;

The disclosure will be buried among a plethora of documentation, so that its significance is obscured or the customer is deterred from reading it.

- ***It will be difficult in practice to disclose information which equips the customer to understand the implications as well as the facts of what is being disclosed;***

For information to be meaningful and effective it should volunteer the information that a prudent customer needs and would expect to be given in order to make informed judgements. It should also dispel any incorrect latent or expressed assumptions which it is reasonable to believe exist on the customer's part. In this respect, we have no doubt that the overwhelming majority of lay customers assume that when they are referred by one lawyer to another, the lawyer to whom they have been referred has been selected as best able to meet the customer's best interests. For that assumption not to be misplaced we believe that customers need to know not merely that the referring lawyer has gained some specified advantage from the referral, but also –

Whether it is the normal policy or practice of the referring lawyer to seek to refer customers only "in-house" or in exchange for some financial advantage from the person to whom the customer is referred;

Whether the receipt of advantage to the referring lawyer, and its nature and amount are in line with standard market practice.

Whether and if so how, the customer will benefit from the financial advantage obtained by the referring lawyer;

The grounds on which the lawyers that do not pay the referring lawyer for a referral are regarded as no better able to meet the customer's best interests;

If the LSB is correct in equating a referral to a not incompetent lawyer as serving customers' best interests (a view we do not share - see (ii) below), then the customer should be told, without having to ask, that the referring lawyer's role is limited in this way and there are no warranties that the lawyer to whom the customer is referred is suited, beyond merely being competent, to meet the customers' best interests.

- ***Experience suggests that “nefarious” arrangements will move underground, and that regulatory enforcement of disclosure will be uncertain.***
- ***Even if a customer is alerted to the potential significance of arrangements between the referring and the recipient lawyers, it does not follow that they can use that information to their advantage.***

As research by The Law Society found, and as most lawyers can bear witness, “Some customers find it intimidating and difficult to talk to solicitors”. It is not fanciful to suggest that it is the most vulnerable customers who would have the most difficulty in challenging their lawyer about their receipt of referral fees or other advantage, or about the impartiality of their selection of the lawyer to whom they are being referred.

(ii) A competent lawyer is not necessarily thereby best placed to act in the customer's best interests

2.8 As in the case of disclosure, there is clearly a place for ensuring that there are adequate standards of competency across the whole of the legal services market.²

2.9 However in our view the requirement in Section 1 of the Act that lawyers serve their customers' *best* interests requires rather more than that the lawyer to whom a customer is referred is “competent”.

2.10 Even if one accepted that mere competence was sufficient, “competence” is a subjective concept. It is more than the end result of passing examinations and attendance on courses but rather the accurate, skilful and diligent application of knowledge gained. It is not realistic to assume that regulators will ever challenge a referral on the grounds that the recipient of a referral and who has paid for it may have been reasonably competent but was not as competent as others who could have been selected (some or many of whom would not pay for referrals).

² It appears that LSB is not confident about concluding that there is no evidence of customer detriment in criminal advocacy because there has been no means of assessing the competency of such advocacy across all providers. However LSB does not express similar qualms about other legal services markets in which there are no market-wide standards of competency.

2.11 The most it is realistic to expect is that lawyers who are plainly incompetent and/or who are clearly acting against a customer's interests (let alone their best interests) will be identified at some stage - by definition after the damage has been done.

(iii) There are limitations on regulators' ability to enforce a "customer's best interests" duty.

2.12 As we highlight above we believe that hanging everything on twin pillars of disclosure and ensuring that recipients of referrals are competent leaves wide scope for customer detriment in the interstices between not acting against a customer's interests and serving a customer's best interests; and between being not incompetent and being competent.

2.13 It should not be assumed that approved regulators will be able to shore up the damage through effective monitoring and enforcement of the higher standards in each case.

2.14 At best we believe that effective delivery of the "supermarket" standards with which the LSB is content would bring about a legal services market in which the players can get away with not acting against the interests of their customers (as opposed to acting in their *best* interests); in which all players can get away with minimum rather than high standards of competence; and in which a significant element of "caveat emptor" applies regardless of the vulnerability of the customer.

2.15 If that is not the LSB's vision of the "market" then it should, at the least, require approved regulators to spell out to it, the public, and their regulated constituents the tests they will apply in determining that a referral – whether or not in exchange for financial or other advantage - is in the *best* interests of a particular customer, and only then determine whether the proposals in the Discussion Paper will be sufficient to serve those best interests.

3 Evidence of customer detriment

3.1 Although we share the objective of basing regulatory policy on evidence of customer detriment, we do not go so far as the LSB in assuming that where there is no quantifiable evidence of systematic detriment that proves there is no such detriment.

3.2 The following, in combination, suggest to us that in the case of lawyer to lawyer referrals it would be unwise to assume that the undoubted conflicts of interest on the part of lawyers when making referrals in exchange for payment in cash or in kind are resolved in customers' interests to a satisfactory extent –

- Instances of barristers being offered work conditional upon their paying the referring lawyer in cash or in kind for the referral – a lawyer who is selected as best placed to serve the customer's needs does not become badly placed to do so by virtue only of refusing to pay for the referral;
- The purpose of referral fees and allied arrangements is to influence the choice of the referring lawyer – if they did not succeed in doing so they would not be paid;

- In markets where referral fees or fee-sharing take place, their level has been bid up over the years – this can only be due to referred business being auctioned;
- Volumes of business received by lawyers who pay referral fees to non-lawyers can be up to one hundred times that received by lawyers who do not pay them. The multiple may be different in the case of lawyer to lawyer referrals but the trend is the same – business is increasingly referred to lawyers who buy it – and is done so at a competitively high price. We think it implausible to say the least that a lawyer who selects from among only those lawyers prepared to pay him has reached a well-reasoned conclusion that no lawyer who does not pay for a referral is ever better placed to meet the needs of his customers, and that the lawyers prepared to pay for referrals, and compete in the auction for them, happen to be the cream of the competition. In all other markets, the converse can be expected to be the case – you pay for what you cannot attract on merit.

3.3 That the SRA is seen as having no evidence of systematic customer detriment where referral fees are paid is not proof that there is no incidence of such in practice. The lack of quantifiable evidence could be due to the fact that SRA's monitoring capability is, as we have suggested above, limited to identifying flagrant detriment.³

3.4 Experience of financial services regulation demonstrates that regulators rarely if ever find their constituents in breach of their duty to act in customers' best interests through the quality of advice they give save where that advice is blatantly bad. Rather they usually base their disciplinary actions on more objective grounds such as failure to have taken sufficient steps to ensure that the advice was appropriate – offering no opinion on whether or not the advice was in fact appropriate - or failing to warn customers of the risks.

3.5 We suspect that this may be true also of SRA's regulation of solicitors' alleged not to have acted in a customer's best interests - e.g. failing to inform the customer of their right to choose; over-charging etc. We would be interested to see evidence of disciplinary action having been brought against a regulated person on the grounds only that they had failed to select the provider of specialist advice and advocacy services best placed to best serve the customer's best interests.

4 The International position

4.1 Article 5.4 of the Council of Bars and Law Societies of Europe (CCBE) Code governing the conduct of "European cross-border activities", prohibits lawyers from demanding or accepting from another lawyer or any other person a fee, commission or any other compensation for referring or recommending the lawyer to a customer; or from paying anyone a fee, commission or any other compensation as a consideration for referring

³ Though it is claimed that there is no evidence of systematic detriment from lawyer to lawyer referrals, there is well publicised evidence of the most severe detriment arising from non-lawyer to lawyer referrals, namely the behaviour of Thompsons and other solicitors' firms who were reprimanded by the Solicitors' Regulation Authority for their conduct in handling compensation claims by miners for industrial disease. This event did great damage to the reputation of solicitors and the trust that could be placed in them.

customer to him or herself. UK lawyers are therefore prohibited from paying referral fees to non-lawyer introducers situated in a CCBE state other than the UK.

4.2 The rationale for this rule is set out in the Commentary to the CCBE Code of Conduct is

"[To reflect] the principle that a lawyer should not pay or receive payment purely for the reference of a client, which would risk impairing the client's free choice of lawyer or the client's interest in being referred to the best available service."

4.3 We believe that insufficient thought has been given to the implications of UK lawyers being free to adopt referral fee practices which are out of step with the standards thought acceptable for EU lawyers generally and enshrined in the European Code of Conduct for Lawyers.

5 Conclusion

5.1 We remain firmly of the view that the LSB needs to go further in respect of lawyer to lawyer referrals and satisfy itself that approved regulators among them –

- Define adequately the criteria by which customers' best interests are judged;
- Have before the event monitoring arrangements for detecting referral arrangements which do not serve those best interests, having test driven these in advance;
- Regulate lawyer to lawyer referral arrangements in ways which ensure that the interests of the referring lawyer are subordinated to those of customers, including defining circumstances in which arrangements offered to a referring lawyer would, if accepted, preclude the lawyer from acting for a customer.

5.2 We have suggested previously that the LSB might want to take the lead in co-ordinating a cross- approved regulator approach to this legal services market-wide issue – an issue which in our view tests the system's ability to deliver the regulatory principles. At the least, the LSB should recognise the need to go further than it is apparently inclined to go in seeking assurances that the system will deliver legal services which serve customers' best interests.