



The Law Society
of England and Wales

Referral fees, referral arrangements and fee sharing

**Discussion document by the
Legal Services Board**

Response by the Law Society
of England and Wales
December 2010

SUPPORTING
solicitors

1. INTRODUCTION

The Law Society is the representative body for over 140,000 solicitors in England and Wales. It negotiates on behalf of the solicitors' profession, lobbies regulators, Government and others. It also works closely with stakeholders to improve access to justice for consumers.

We welcome the opportunity to respond to the Legal Services Board's (LSB) discussion document on proposals for reforming referral fees, referral arrangements and fee sharing.

The Law Society has been concerned about referral fees for many years and welcomes the consideration that the LSB has given it. We are disappointed, however, that the Board does not appear to have given sufficient consideration to the real problems that referral fees appear to be causing.

The Law Society's view is that:

- The evidence and research backing the LSB's view is not sufficient to justify this conclusion;
- It is disappointing that the LSB is not offering up for discussion the option of banning referral fees.
- The transparency model is fraught with problems. It does not address the risks inherent in referral fees. The present position which, effectively, requires solicitors to police referral fee arrangements creates a potentially impossible situation for solicitors and has been shown to be ineffective.
- There should be proper regulation of those receiving the fees so that (a) they are required to comply with the requirements of transparency and (b) there is proper redress and compensation from introducers where consumers who are referred to inappropriate solicitors; and
- Solicitors should not be permitted to receive referral fees other than from people who are regulated by a scheme.

2. THE EVIDENCE BASE

The LSB position in the discussion document relies heavily on the research by Charles River Associates (CRA)¹. We note the LSB indicates that the methodology used by the Charles Rivers Associates was standard for such surveys. However, the Law Society considers the conclusions that the research sets out are problematic and that the methodology behind it did not support the definite conclusions drawn:

- The size of the sample was far too low to cover the three areas of work when there are a wide variety of practitioners and suppliers (likely, overall, to be in the tens of thousands) and variations within the work types.
- There was no transparency about the research, the sorts of sample used, how they were split or the methodologies for the external survey evidence.
- A number of the proxies that were used, particularly in the discussions on conveyancing, were from people with an 'axe to grind'.
- The evidence of consumer detriment is, by the very nature of the work, hard to find by use of the enquiry techniques employed. Consumers will not necessarily realise that, in PI cases, a matter has under-settled and may not

¹ Legal Services Board (2010). 'Referral fees, referral arrangements and fee sharing: Discussion document on the regulatory treatment of referral fees, referral arrangements and fee sharing', pub: LSB: London.

ask whether the lawyer concerned is the most suitable for them. Mistakes in conveyancing transactions may not be discovered until the consumer tries to sell the house many years later. By the very nature of the work the consumer is not able to easily to assess quality standards.

The CRA research established a number of the main issues. However, to base a series of policy proposals on the back of it is to draw conclusions prematurely. What is needed is further research to build up a rigorous evidence base that thoroughly investigates the evident risks in the existence of referral fees and their full long-term impact on access to justice, consumers, the legal profession and the good functioning of legal services markets in the public interest.

3. THE PROBLEMS WITH REFERRAL FEES/ ARRANGEMENTS

The Law Society considers that referral fees have no place in markets for legal services. This is for a number of reasons:

- They damage access to justice.
 - The referrer operates at the earliest stage of the transaction. This enables them to direct consumers to a particular provider who is likely to be the one who pays the highest referral fee.
 - The perverse incentives created by referral fees lead to situations where solicitors might have no choice but to spend less time on cases, reduce the scope of their work or refuse the more complex cases.
 - In the longer term the economics of referral fees creates a strong likelihood that some solicitors will be driven off the high street and thus consumer choice and access to advice and representation will be reduced.
- They limit consumer choice.
 - The consumer is often likely to choose the solicitor recommended by the referrer (even though they may not be the most appropriate for their needs). This might be because recommendations can exploit inherent consumer biases; consumers feel obliged (in order for their business to be successfully completed) or because of pressure from the referrer². Any of these situations de facto limits consumer choice. A good example of this restriction of choice is the insurance industry and the issue of Legal Expenses Insurance (LEI). Insurance policies often contain restrictions on the freedom of choice of solicitor (who are usually chosen from panels set up by Insurers) to deal with a case on commercial terms which are favourable to the insurers and agreed as a condition of being a member of the panel. This clear limitation on the ability of the consumer to choose (facilitated by referral fee arrangements) is a restriction the Law Society opposes. It is detrimental to the consumer and inhibits the proper functioning of this particular area of the legal services market. It is particularly notable that insurers, in effect, sell claims to the highest bidder, the solicitor then takes the claim on a conditional fee basis with no cost to the

² The Consumer Panel found evidence of estate agents pressuring clients to use their recommended conveyancer. Source: Legal Services Board (2010). 'Referral fees, referral arrangements and fee sharing: Discussion document on the regulatory treatment of referral fees, referral arrangements and fee sharing', pub: LSB: London. Legal Services Consumer Panel (2010). 'Referral Arrangements', pub: LSCP: London.

- insurer who, in fact, makes money out of the claims. It is easy to see how the interests of the consumer are marginalised.
- Referral fee arrangements create a new market for intermediaries who are at liberty to incentivise the bidding up of fees paid to referrers. This will be particularly prevalent where there is 'case auctioning'³. There are direct implications for the consumer as higher costs caused by the payment of ever higher referral fees will end up being passed through to consumers. The alternative is less time spent on cases, refusals to take on some types of cases or firms going out of business.
- They discourage an independent, strong, diverse and effective legal profession.
 - Referral fees create a dependency relationship that generates a tension between a solicitor's duty to a client and an unwillingness to offend a source of regular work. This is a duty the LSB is statutorily bound to uphold⁴. Referral fees may bring into doubt the ability of the LSB to do this.
 - The long term consequence of fewer legal firms on the high street is inevitably a less diverse and more homogenised legal services sector.
 - They do little to increase public understanding of the legal rights and duties of citizens or of the choices available to consumers in relation to their particular needs. In this respect they reduce the transparency of the market.
 - Supporters of referral fees often claim that one of the positive spill-over effects from the work of claims managers is they educate the public on their legal rights. In addition they act as a selection mechanism whereby those cases unlikely to succeed are filtered out early. Research commissioned by the BBA in August 2009⁵ indicated that many claims managers did not provide valuable and accurate representations of consumers' rights and their legal position.
 - They create adverse incentives contrary to the professional principles of solicitors.
 - Referral fees could have an adverse effect upon the integrity (and wider public perception) of the legal profession. When a monetary relationship is entered into, it creates a qualitatively different kind of relationship. Money changes the expectations and behaviour of the parties involved in the relationship. A pressure to behave in certain (potentially detrimental) ways is exerted on the parties, especially those who pay the referral fee.

These very real problems with referral fees and the risks inherent in their continued use (outlined above) are why the Law Society is disappointed the LSB are not offering the option of prohibition in the discussion document.

³ The Consumer Panel recommended prohibiting this practice. Source: Legal Services Consumer Panel (2010). 'Referral Arrangements', pub: LSCP: London.

⁴ Part 1 of the Legal Services Act 2007 sets out the regulatory objectives. Part 2 sets out the Board's duty to promote the regulatory objectives. Source: OPSI (No date given). 'Legal Services Act 2007', pub: legislation.gov.uk, accessed at: <http://www.legislation.gov.uk/ukpga/2007/29/contents>

⁵ GfK NOP (2009). 'Impact of Claims Management Companies' Activities on Consumers of Financial Services', pub: British Bankers Association: London.

4. REFORM PROPOSALS IN THE DISCUSSION DOCUMENT

The proposals in the discussion document are based around a transparency model. The Law Society considers that this is not a complete solution to the problems created by referral fees. The transparency model does not:

- Significantly alter the economics of the referral fee system or the ability of some referrers to exercise market power over those who they refer cases to.
- Reduce the ability of the referrer to pressure consumers into choosing a particular legal service provider.
- Mitigate the long-term risks to access to justice.
- Help the consumer where they do not know or care whether they are getting the best legal service available i.e. when they are unaware that they are suffering any detriment. Those that do care may not have the requisite resources to understand and identify whether a risk arises out of a particular referral arrangement or the level of the fee being paid.
- Provide adequate redress for the consumer if poor referrals are made.

Transparency simply tells the consumer that a fee has been paid. It does not necessarily create a better functioning market or enable the consumer to judge the implications of the payment. Even if the LSB takes the view that it is sufficient simply to ensure greater transparency then there are a number of further steps that can be taken to mitigate at least some of the risks associated with referral fees.

Our comments will focus on two areas of the proposals. Firstly, on the information consumers will be given by the solicitor in relation to any relevant referral fee arrangement. Secondly, the suggestion that solicitors can police the referral fees system effectively, while claims management companies and estate agents effectively remain poorly regulated in this respect.

4.1 INFORMATION GIVEN TO THE CONSUMER

The Law Society welcomes the fact that the proposals will require key information to be disclosed to the consumer. However, there is a clear problem when there is limited regulation of those who receive referral fees. This places most of the burden of complying with regulation on solicitors. There are real practical difficulties for solicitors who end up, in effect, regulating third parties over whom they have no effective policing mechanisms.

In July this year the Law Society wrote a letter to the LSB setting out the kinds of information any credible disclosure regime must include⁶. It is encouraging to see three of the four proposals the Law Society made taken on board by the LSB. However, the Law Society suggested one further piece of information that should be disclosed:

- The solicitor should only accept work where the referrer has complied with the requirements of our code and the client should notify the solicitor if those rules have been breached.

⁶ Letter from Mark Stobbs, Director of Legal Policy at the Law Society of England and Wales to Chris Kenny, of the LSB.

It is disappointing this is not also included in the LSB proposals. This measure would help uncover bad practice and provide at least some element of incentive for better practice by referrers.

In addition, information has to be expressed in a consumer friendly manner. This means an obligation that information is written down in a clear manner. In line with the proposal in the discussion document the method need not be prescriptive, as long as the obligation is in place. A consumer needs to be able to understand and interpret the information to make use of it; mere provision of information alone can lead to more confusion.

There are many other detailed questions around the transparency model that the discussion document does not adequately tackle. If transparency is to be an effective tool, they will need much consideration.

- The intentions of the LSB seem to be to expand the definition of what a referral arrangement is. The question then is how can this be done in a way that does not create confusion for those subject to the regulations while at the same time capturing the range of methods that might be employed to 'game' the regulations⁷? Clear proposals on how to go about ensuring it can be done sensibly are vital.
- A wide definition might mean arrangements which are currently not written down, having to be written down in future. This will be an added burden on law firms and is a potential recipe for confusion with clear guidance essential to ensure all arrangements falling under the definitions are included.
- The proposal to publish referral fee agreements will also be time consuming and burdensome, for both law firms and regulators.
 - Clear rules need to be set down as to what will be done with commercially sensitive information and who will make the decision as to what is sensitive information and what is not. This has the potential to be a very complex issue that could be an ongoing problem.
 - The time and effort involved in placing disclosed agreements on a central website will be considerable. There are questions over whether regulators will have the capacity to keep up with the inevitable frequent changes in referral fee arrangements as old ones expire, existing ones are modified or new ones are entered into.
 - The regulatory costs of this will no doubt be passed onto the legal profession. This is particularly unfair on those firms who do not participate in referral fee arrangements but will end up bearing some of the regulatory costs.

4.2 PROTECTION FOR THE CONSUMER

Transparency does not guarantee better outcomes. Currently SRA Rule 9 should ensure some of what is discussed in the LSB document already happens but there are significant difficulties in enforcing it because, as has been suggested, it is impractical for solicitors adequately to police those to whom they pay referrals. The proposals from the LSB will 'live or die' by how well they are enforced. Effective enforcement will only come about if all key interests in the referral fee chain are regulated. This means the adequate regulation of those who make referrals (i.e.

⁷ The definition might have to include marketing arrangements such as annual marketing fees or arrangements such as services provided free or at discount rates as these might be used to avoid any disclosure requirements.

those who receive referral fees). Even if it is correct to say that referral fees can provide benefits for the consumer, there is the clear potential for detriment. We believe that it is essential that there should be mechanisms for providing redress for consumers who suffer detriment and the person receiving the fee should be at risk as well. There are two main areas where sanctions should apply:

1. As the Law Society has suggested, the referrer should pay the amount of the referral fee back to the consumer if he or she does not comply with the requirements of transparency;
2. In addition, the consumer should be able to seek redress from the referrer if, in fact, the person to whom the case is referred is unsuitable.

Both of these will require a regulator who can enforce such requirements. At present, however, there is limited regulation. Those involved in claims handling are regulated by the Claims Management Regulator but we doubt that it has the capacity to enforce such requirements at present. However, many of those who pay such fees in relation to conveyancing and other non contentious work are outside regulation – particularly estate agents.

The Law Society therefore believes that:

- Referral fees should only be paid to people who are regulated by a body whose rules are appropriate and has an adequate enforcement mechanism;
- The rules should include the duties of transparency required by the LSB and should provide that the referrer must satisfy him or herself that the service provided is suitable for the requirements of the consumer;
- Failure to comply with these duties should mean that the referrer is required to pay the fee back to the consumer and appropriate compensation;
- These provisions should apply to all bodies paying referral fees, including insurers.

These arrangements would have the benefit of providing adequate protection for consumers in the event of referrals being abused. We believe they could be achieved by a rule prohibiting solicitors from accepting referrals from bodies who were not part of an approved scheme. It would also mean that the inappropriate burden of policing referrers could be removed from the profession.