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Dear Lesley,

Consultation on Referral Fees, Referral Arrangements and Fee sharing

Thank you for sending us your consultation on the regulatory treatment of referral fees, referral arrangements and fee sharing.

We endorse the consultative and evidence based way the LSB has come to its conclusions on referral fees and overall we support the resulting recommendations on making referral fees more transparent.

With regard to recommendation one on transparency to the consumer, this seems reasonable and may facilitate shopping around by the consumer thus promoting more effective competition among legal service providers.

However, we believe it may be of some benefit to you if we highlight some of the theoretical situations where there may be competition concerns with the second recommendation for improving transparency and disclosure in the market.

We note that in recommendation two it is stated that Approved Regulators should collect and publish all agreements between introducers and lawyers. If price information is included in this publication then this can have an effect on competition in the market. It may decrease prices by increasing the ability of payers of referral fees to understand the going rates, but increased transparency may have anti-competitive effects by facilitating



price collusion between the introducers themselves. This may ultimately lead to increased prices for consumers.

Such an anti-competitive effect is more likely where high entry barriers and few players means that disruption to collusive behaviour is less profitable. Fewer firms mean that it would be more profitable to follow the collusive price without deviating for short term gain. In addition if a rival's threat of punishment in response to a deviation in price is credible and sufficiently severe, due to high entry barriers, then this may reinforce and sustain the collusive behaviour.

As an illustration of our concerns we refer to a case study that was carried out by the Danish anti-trust authority on the Danish concrete industry¹:

'Arguably the strongest evidence on price communication is by Albaek et al. (1997). The Danish anti-trust authority decided to gather and publish firm-specific transaction prices in the ready-mixed concrete industry. The aim was to promote competition by increasing transparency (in particular for buyers). The result of the policy, however, seemed exactly opposite to the authority's aim. Average prices increased by 15-20 percent within a year following the initial setup. This 'natural experiment' provides quite compelling support for the concern that open prices may well be high prices'.

It should be noted that this study is unique in its kind and unfortunately there appears little more empirical evidence to support the concerns raised above. In practice we may know very little about how important communication is to establish collusive outcomes.

In a market where there are low barriers to entry and there are many players, we believe that collusive behaviour by firms would be less likely, and the chance of a negative effect of recommendation two is thus lower. The easier it is to enter into a market the more difficult it is to sustain collusive behaviour because of the likelihood of new firms, being attracted by the high prices, entering and undercutting price. In addition where the market is characterised by the existence of many players, there is a greater chance that existing firms may wish to benefit by undercutting a collusive price and gaining market share.

¹ Excerpt from Potters, Jan. (2005) *Transparency and Collusion. Experimental Evidence*. 1st draft. Prepared for the Encore Workshop "Experiments for Antitrust Policies" pp3-4

Given what we know of both the legal services and introducing sectors, we suspect that those paying referral fees are already well informed, and that the beneficial effect on competition of price transparency will thus be limited. It is harder to draw a conclusion on the chances of price transparency facilitating collusion since we are unaware of the relevant geographic size of the markets. If referral fees are mainly set locally, then the relevant market may be quite small, with relatively high barriers to entry, and genuine risk of collusion. If set nationally, then the risk of harm would be substantially lower.

On balance, we would therefore hazard that there is a low but non-negligible risk of price transparency facilitating collusion in some local markets. As a consequence, we would recommend caution in publishing prices as part of recommendation two.

We hope this proves useful to your consultation.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'David Stallibrass', with a stylized flourish at the end.

David Stallibrass
Director, Services.