

Referral fees, referral arrangements and fee sharing

Discussion document on the regulatory treatment of referral fees, referral arrangements and fee sharing

September 2010

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Foreword by the Chief Executive

Referral fees are a contentious feature of today's legal services marketplace.

On the one hand it is argued that they are economically inefficient and morally indefensible - that it is simply wrong to trade individuals' legal requirements, that doing so drives up costs and charges and hence reduces access to justice.

On the other hand, it is argued that referral fees are simply a legitimate client acquisition cost. Lawyers have not always been effective in marketing their services and some clients have been left unserved. Claims management companies and insurance companies have therefore helped to correct this deficiency in the market and so furthered the cause of access to justice. For this service, a fair profit is justified and the ability of lawyers to pay fees for their services should not be denied.

But those arguments have rarely been backed by hard empirical evidence. The Legal Services Board is filling that gap by ensuring that an assessment of the operation of referral fees is informed first by economic evidence, second, by the views of consumers directly and third, by the opinion of consumer representatives in the form of our own Consumer Panel.

This document sets out our own first thoughts emerging from this work. They are not definitive. This document is the basis for further consultation and discussion before we reach final conclusions early next year. Our scrutiny has been focused on the regulatory treatment of referral fees, assessed against the regulatory objectives set out in Section 1 of the Legal Services Act 2007. We do not offer a view on any wider public policy arguments for their retention or abolition.

The view of our Consumer Panel, can be summarised in their conclusion of "reveal, regulate so retain". The Panel argue that the last element depends on the delivery of the first two, which are of equal importance. The Board broadly believes that this provides a clear basis for further discussion.

Our preliminary hypothesis is that the simple solutions of an outright ban or a laissez faire free for all are both unacceptable. The first proposition would, in our view, be a wholly disproportionate action when the economic evidence is that consumers do not suffer detriment from the existence of referral fees and, indeed, that there may even be access to justice benefits from their retention. Lawyers are under no obligation to pay such fees: independent marketing is a viable alternative. To outlaw such practices when viable alternatives exist therefore could fail a test of regulatory proportionality.

But it would be wrong to ignore the public, professional and judicial concern about referral fees. As marketing in this area is not wholly effective, the level of costs for customer acquisition is almost certainly higher than it would be in a better functioning market. Customer acquisition costs should fall over coming years, partly because of better technology, greater managerial sophistication in law firms generally and because of increased competition with the advent of Alternative Business Structures (ABS). New ABS firms may emerge that capture the entire value chain of both customer acquisition and legal advice, so reducing excess profits. The question for regulation now, is how best to put incentives in place to reinforce ethical behaviour that maintains public confidence, whilst making the market work more effectively.

We believe that the Consumer Panel's recommendation about transparency is crucial. There need to be two levels of transparency. There needs to be transparency to the individual client. This includes transparency about the existence of a fee and its level and, above all, lawyers must make clear to the individual that they retain the right to "shop around" rather than have their case traded.

We believe that there is a need to make the level of referral fees more transparent generally: to the marketplace, to consumer bodies and to commentators. We believe that this level of transparency will aid general economic efficiency, allow for the accurate tracking of trends and give firms every incentive to consider actively where and how to invest to acquire work in a way that minimises their own costs and contributes to lower charges for consumers.

This also implies that the regulatory role must be active. A regulatory framework for transparency must be policed and, where necessary, enforced. The alternative to an outright ban or free for all is active regulatory oversight.

Regulators will need to keep their own frameworks and enforcement activity under active review over the coming five years in the light of changes within the legal services market generally. What constitutes a proportionate response now may well not do so in a world of more general ABS penetration or, indeed, in an era in which the level of legal literacy in the general population has increased. Both the nature of the challenges faced by regulators and the efficacy of potential solutions will change over time. The issue will therefore remain on the agenda of the Legal Services Board and that of the approved regulators whom we oversee.

We want to test our thinking in this paper with a wide range of consultees over the coming months and reach a final policy position early next year. At that stage, we will invite approved regulators to review their own practices in the light of our conclusions. We will then work with approved regulators on implementation.

The Board is grateful to those who have helped in the development of this work to date. We invite all concerned with access to justice and the efficient working of the legal services market to study our preliminary conclusions closely, and look forward to hearing views.

Chris Kenny

Chief Executive

1. Executive summary

Background

- 1.1 Referral fees and arrangements are a feature of the commercial landscape across the economy, acting as vehicles through which consumers access professional services. Solicitors have been permitted to enter into these arrangements since rule changes in 2004, when restrictions were lifted in that part of the legal services sector.
- 1.2 Whilst common elsewhere and permissible for most lawyers, their impact in the legal services sector has been controversial owing to concerns over the independence of lawyers.
- 1.3 With strongly held views on both sides, the debate has been characterised by powerful representations but a lack of definitive evidence. Since the inception of the Legal Services Board (LSB), organisations both inside and outside the legal services sector have petitioned us to set out a new regulatory approach for the management of these arrangements. Along with our partners, the approved regulators, we must give effect to the eight regulatory objectives set out by the Legal Services Act 2007 (the Act).
- 1.4 In both of our business plans to date, we have reiterated our intention to be an evidence-based decision-maker and to make regulatory decisions that are proportionate in addressing aspects of the market that are causing consumer detriment. To this end, we have completed a thorough investigation into referral fees that culminates in the proposals announced in this report. We will develop them further in light of feedback generated by this discussion document with a view to reporting on a final set of conclusions and recommendations in spring 2011.

Purpose

1.5 The purpose of our investigation was to produce comprehensive evidence on the impact of referral fees. The evidence we have uncovered has allowed us to reach some important conclusions and proposals about how to approach the arguments posed by referral fees.

Methodology

1.6 Our investigation gathered evidence from a number of sources, bringing together both existing material and new data, whilst working collaboratively with partners throughout that process.

1.7 Targeted examination of the attitudes and interests of consumers themselves was a major priority. In November 2009, we announced our intention to ask the Legal Services Consumer Panel to provide advice to the LSB on the impact on consumers of the referrals element of transactions. The Consumer Panel asked Vanilla Research to undertake qualitative research to underpin their advice, which examined consumer attitudes to referral arrangements.

1.8 We also commissioned Charles River Associates (CRA) to produce modelling to build an assessment of the full economic impact of referral fees. This provides the strict economic impact strand of the evidence base and addressed factors such as consumer choice, competition and quality.

1.9 Whilst calls for evidence marked the launch of the Consumer Panel and the Board's inquiries, we took care to offer further opportunities for stakeholders to respond to emerging thinking. Partners both inside and outside the sector were invited to seminars and workshops in order to provide opportunities for further engagement. At each stage of the process we published findings online and invited comment, maintaining the levels of transparency to which the Board has committed itself.

Evidence

- 1.10 The Consumer Panel announced a series of findings in its advice to the LSB, released in May 2010. The Panel's report concluded there was not sufficient evidence to suggest that the independence of lawyers is being compromised by the referral element of transactions. However, linked to concerns over independence and delivering the highest quality service to the client, complaints were raised over pressures on consumers in favour of the law firm which has the relationship with the introducer. Weighed against this, the Panel found that referral fees deliver benefits for widening access to justice – particularly in the personal injury arena - through raising awareness of the right to take action and facilitating the claim process.
- 1.11 The Panel considered the impact of referrals on competitive pressures in the market, examining this across the factors of quality, price and choice. Findings indicated that satisfaction with the quality of the transactions involving referral fees was at least comparable with that achieved in other cases, whilst in some cases it was higher. Research suggests that this may be due to economies of scale brought about by investment in IT and case management support. On price, conveyancing rates charged to clients were found to be lower amongst firms paying referral fees. Findings were mixed when it came to consumer choice. More diverse providers on the one hand increased options for consumers, but issues such as fixed membership of introducer panels caused concerns that the Panel thinks should be addressed.
- 1.12 The Panel concluded that the prohibition of referral fees would be an excessive reaction, and that a well-designed regulatory regime of outcomes, rules and active management should be capable of managing the concerns that emerged. To support this conclusion, the Panel produced a range of recommendations for transparency measures that would empower consumers and improve their ability to make informed decisions in transactions involving referral fees.

1.13 The Board's economic research produced findings that addressed the impact of referral fees across the conveyancing, personal injury and criminal advocacy markets. In the conveyancing field, whilst referral fees had risen over time, evidence suggested that the fees paid by consumers were lower in transactions involving an element of referral. As suggested by the Consumer Panel, this may be due to greater investment in technology and support services in respect of introducers. Alongside this, rates of complaints suggested that the quality of conveyancing was not being diminished. In personal injury cases – the area in which referral fees are most common – we found no evidence that quality had diminished or that prices had risen. Additionally, evidence suggested that the extra impetus on marketing means that justified claims are being made that would not otherwise have been pursued – contributing to the widening of access to justice.

Conclusions

1.14 In view of these findings, we do not believe there is sufficient evidence to sustain a prohibition of referral fees in the personal injury and conveyancing markets. Nor do we think that other consumer-facing legal services markets should be treated differently. and, as such, conclude that bans cannot be justified on the current evidence. However, in common with the recommendations of the Consumer Panel, we conclude there is evidence that current disclosure arrangements do not always work effectively. Disclosure is a crucial part of ensuring that consumers know the details of the deal they are getting. Yet there is evidence that, in many cases, these rules are not complied with. The disclosure and compliance problems identified exacerbate information asymmetries and other complexities in the legal services market – so undermining confidence. We believe that these problems require regulatory intervention.

1.15 Alongside conveyancing and personal injury, criminal advocacy was also reviewed as part of this investigation. Although referral fees and arrangements are not, in and of themselves, used in this area, fee-sharing arrangements have the same impact and are clearly in use. Our findings indicate that there is no

systematic evidence that fee sharing is reducing quality in criminal advocacy. However, making quality comparisons across providers is problematic. The work underway on a Quality Assurance for Advocates (QAA) scheme will address this. Such a scheme will not only provide the basis for assessing quality but, when accompanied by strong regulatory action, will also ensure that criminal advocacy is at the required standard.

1.16 We believe that the policy objective must therefore be to preserve the beneficial impacts of referral fees in the legal services market, while addressing the important concerns and confidence issues that have been highlighted. In this way, both consumers and legal services providers will continue to benefit, whilst new protections will be introduced to protect and promote confidence and compliance. Such protections will be by way of management measures surrounding disclosure and transparency rather than by any prohibitions.

New proposals for transparency

1.17 We propose that disclosure obligations on those organisations using referral fees need to be strengthened. This is key to strengthening consumer protection in this area, better enabling the consumer to understand the referral element to transactions and allowing them to make discerning judgements on the service they are purchasing.

1.18 The following are our key proposals on transparency measures:

- **Improving transparency and disclosure for consumers**

The legal provider should disclose to their clients the key facts about referral fees:

- whom the referral fee is paid to and for what services
- the value of the referral fee in pounds

- the consumer's right to shop around for an alternative legal services provider.

- **Improving transparency and disclosure in the market**

Approved regulators should collect and publish all agreements between introducers and lawyers.

All agreements for referral arrangements should be in writing.

1.19 The aim should be for consumers to receive information at the point at which it can best aid their decision-making. Unless there is strong evidence that receiving this information more than once brings significant consumer benefit, the intention should be that it is provided only once. Ideally, regulatory disclosure should be delivered when the consumer is first referred to the lawyer by the introducer. However, the regulation of introducers is outside the remit of the LSB and so we have concluded that regulation should continue to require disclosure by the lawyer.

1.20 It is fundamental to our approach to legal services regulation that interventions should at all times be proportionate – recognising that the regulatory burden ought to be kept as low as possible in order to maximise commercial freedoms across the market. The new transparency regime we propose has been shaped with this guiding principle in mind. We have sought to design the new framework with the objective of ensuring sufficient consumer protections, but have not gone beyond what we consider to be the measures necessary to achieve this. To a large extent, the measures outlined simply bring together existing obligations in the case of many legal services practitioners. For example, in relation to disclosure of the existence and the amount of a referral fee, this is no more than solicitors are already required to do in order to comply with Rule 9 of the SRA Code of Conduct. For solicitors, therefore, this does not amount to an extra burden.

1.21 In addition to transparency measures, we have also set out our expectations as regards approved regulators' approach to delivering active regulation in this area. We want to see a seriousness of intent towards ensuring the upholding of the professional principles and regulatory objectives. To this end we propose that:

- **Approved regulators should set out their compliance strategy for referral fees and arrangements when setting out their regulatory arrangements.** In particular:
 - Approved regulators should publish information about the operation of referral fees amongst their regulated community
 - Where compliance with referral fee rules is low, approved regulators should have targets for improved compliance
 - Approved regulators should have rules which are, where appropriate, consistent across areas of law with other approved regulators.

Questions for consultation

The LSB welcomes any comments on its consultation. It would be helpful however if consultees could comment by way of response to the following questions:

CHAPTER 5

CONCLUSIONS – PERSONAL INJURY AND CONVEYANCING

1. Do you agree with our analysis of the operation of referral fees and arrangements?
2. Do you have additional evidence about the operation of referral fees and arrangements that should be considered by the LSB?

CHAPTER 6

CONCLUSIONS – CRIMINAL ADVOCACY

3. Do you agree with our analysis of the operation of referral fees or fee sharing arrangements in criminal advocacy?
4. Do you have additional evidence about the operation of referral fees or fee sharing arrangements that should be considered by the LSB?
5. In particular, do you have evidence about the impact of referral fees or fee sharing arrangements on the quality of criminal advocacy?

CHAPTER 7

RECOMMENDATIONS FOR IMPROVING TRANSPARENCY AND DISCLOSURE

6. Will the proposals assist in improving disclosure to consumers?
7. Are there other options for disclosure that ARs should consider?
8. What are the issues relating to the disclosure of referral contracts by firms to approved regulators and their publication by approved regulators?
9. How should these issues be addressed?

CHAPTER 8

RECOMMENDATIONS FOR DELIVERING ACTIVE REGULATION

10. Will the proposals assist in improving compliance and enforcement of referral fee rules?
11. What measures should be the subject of key performance indicators or targets?
12. What metrics should be used to measure consumer confidence?

Next steps

- 1.22 We are consulting on these proposals with a closing date for submissions of **Wednesday 22 December 2010**. Following this, the Board will announce a final set of conclusions and recommendations in spring 2011.
- 1.23 We plan to publish all responses received during the consultation period on our website. While we are happy to discuss varying this general policy in individual cases, there is a strong presumption in favour of transparency. We will therefore note publicly that a submission has been received from an identified body which had withheld its consent for publication in the summary of the consultation.
- 1.24 We would prefer to receive responses electronically (in Microsoft word or pdf format), but hard copy responses by post or fax are also welcome. Responses should be sent to:

Post:

Michael Mackay
Legal Services Board
7th Floor, Victoria House
Southampton Row
London WC1B 4AD

Fax number: 020 7271 0051

Email: consultations@legalservicesboard.org.uk

The consultation period will end on **Wednesday 22 December 2010**.

Stakeholder organisations are invited to contact the LSB to arrange a meeting to discuss their views during the consultation cycle, if they wish. Please send all requests to consultations@legalservicesboard.org.uk

2. The current regulatory landscape

Defining referral fees and arrangements

2.1 Referral fees and arrangements can take different forms and involve a range of different parties. Although they are common in commercial relationships, they have attracted particular attention when they involve the legal professions. The LSB has focused its attention on those referral fees and arrangements undertaken by approved persons regulated by approved regulators under the Act.

2.2 In undertaking its analysis of the issue of referral fees and arrangements, the LSB has adopted the following definition:

“Any payment made for the referral or introduction of any client or potential client.”

2.3 There is an inherent difficulty in defining referral fees. As we have seen from earlier restrictions on referral fees, it is possible to blur definitions through using sub-contracting arrangements, payment in kind and marketing costs as a cover for the referral fee. It is important to recognise the difference between clear-cut referral fees, referral arrangements and fee-sharing agreements.

- **Referral fees** exist where a lawyer makes a payment to an introducer for the opportunity to represent a client in a variety of circumstances. In this situation, the client contracts directly with the lawyer.
- A **referral arrangement** may exist where a firm may introduce clients in return for free or discounted services.
- In a **fee-sharing arrangement**, the introducer receives the full amount of the relevant fee. The introducer then passes on a proportion of this fee to the referred lawyer.

- 2.4 Analysis by Charles River Associates (CRA) demonstrates that referral fees and arrangements result in the same economic outcome. It goes without saying that in developing a regulatory framework for referral fees, approved regulators need to define clearly the scope of referral fees.¹
- 2.5 The LSB has considered referral fees broadly, but focused predominantly on the areas that were most commonly raised as areas where referral fees are prevalent or problematic - areas of potential and perceived consumer detriment. We developed this focus jointly in discussion with the Consumer Panel and through the Consumer Panel's roundtable event with key stakeholders.² This ensured that all with evidence or opinion on either side of the arguments were given an opportunity to shape and engage with our analysis.
- 2.6 Thus, conveyancing and personal injury (with the emphasis on road traffic accidents) are the two markets that have been subjected to our deepest analysis. These represent the areas that see, respectively, the greatest consumer use of legal services and the widest use of referral fees.
- 2.7 Our work also looked at criminal advocacy in the Crown Court because concerns were raised by some advocates about the impact of fee sharing arrangements on the operation of this market. Under legal aid, advocates in the Crown Court are paid through the Advocates Graduated Fee Scheme (AGFS). There has been an increase in the use of solicitor advocates because changes to the AGFS have encouraged more solicitors to gain higher rights of audience before the courts. There has been concern that this increased use of solicitor advocates has reduced quality. While referral fees are not used in criminal advocacy, fee sharing is common and has similar economic effects.

¹ CRA *Cost benefit analysis of policy options related to referral fees in legal services* (May 2010)

² Consumer Panel Stakeholder Workshop 18 January 2010

Who makes introductions?

2.8 Within the markets that we considered there are different types of introducers. In the property market, it is predominantly the estate agent making the referral. Within personal injury, introductions tend to come from claims management companies (CMCs), insurers and trade unions. In criminal advocacy work, it is the litigator that has conduct of the case and thus makes the referral to the advocate. The litigator is normally a solicitor's firm under the current market structure.

2.9 In the following chapters, we focus on the conveyancing and personal injury markets. In Chapter 6, we set out our conclusions in relation to the criminal advocacy market separately. We have taken this approach because of the real differences between the criminal advocacy market and the other markets where referral is prevalent:

- referral is largely lawyer to lawyer in the criminal advocacy market
- consumers are already connected to the legal market at the point of referral within criminal advocacy
- the actual payment of a referral fee is less prevalent in criminal advocacy
- there remains a ban on the payment of referral fees for the largest part of the criminal advocacy market (i.e. for barristers)

Claims Management Companies (CMCs)

2.10 There are over 2,500 CMCs, which are authorised by the Claims Management Regulator (CMR), delivered by the Ministry of Justice. The CMR was set up in 2007 in response to concerns about the way in which CMCs were operating. Personal injury is the area of law in which more firms disclosed to The Law Society the presence of referral arrangements than any other area of law³. CMCs operate largely in the area of personal injury with a focus on road traffic accidents. Financial services also form a significant area of work. It is generally accepted that the CMC market is competitive.

³ The Law Society *Practice Standard Unit Report on Themed Visits – Referral Fees* (July 2006).

2.11 Research commissioned by the LSB, and carried out by CRA, described three different business models for CMCs:

Ownership

Some introducers are owned by and regulated as solicitors. Other firms have non-solicitor ownership and are regulated by the CMR.

Extent of services

Some CMCs offer a pure referral while others will offer a lawyer a case where almost all of the pre-litigation work has been completed. CRA estimates the range of prices offered for a referral as being between £200 and £800, reflecting the extent of the services offered by the introducer⁴.

Business focus

Some CMCs focus their whole business on claims management. For others, it can be a sideline to their main business activity, for example car hire and vehicle repair firms. These firms may also introduce clients to introducers.

2.12 CMCs and others generally agree that their main function is to connect consumers to the relevant legal service – it is in short a marketing function. Marketing expenditure by CMCs was estimated to be around £35-£40m per annum between 2005 and 2008⁵. Marketing takes the form of press, radio and TV advertising, among other forms. The CRA examination suggests that brand awareness and the availability of free phone numbers are important elements of competition between CMCs along with the ability to offer clients 100% of their compensation in the event of success.

Insurance companies

2.13 Consumers that have purchased either car or household insurance might often also have legal expenses insurance (LEI). In settling a claim against a car or household policy, insurers may advise clients that there is also a potential claim under personal injury law. The income stream derived from referral payments is

⁴ CRA p.94.

⁵ Ibid, p.86.

important to insurance companies, with some of this being used to keep premium costs down in the insurance market. However, it is important to note that insurers claim that the liability costs of referral fee across all legal work far exceeds the income from referral fees in LEI – in other words insurers pay out more in referral fees than they receive by way of income from them.

2.14 Insurance companies often have a panel of law firms to which they will refer clients with potential personal injury claims. There is some ambiguity as to whether consumers are generally given a choice of which law firm to commission in this situation. European legislation says that consumers have the right to choose their lawyer in any legal proceedings.⁶ Case law in the UK has interpreted this as choice being available before the commencement of any inquiry or proceedings.⁷

Trade Unions

2.15 There are almost 200 trade unions with almost eight million members in the UK. In addition to representing employees in employment matters, many trade unions offer their members (and their families) services such as legal representation in the event of personal injury. Trade unions rarely offer these services directly but will have a relationship with a law firm (or firms) to which they will refer potential clients. Often, law firms will deliver the employment representation aspects of their work for trade unions in exchange for the stream of associated claims. In these cases, the employment work might be done freely or at a much discounted rate in return for referrals of personal injury work. This is often described as a referral arrangement.

Referrals in other parts of the law

2.16 Referral fees can be described as a cost in the market. They are recognition of the need to connect consumers with legal services. We acknowledge that there is no reason to believe that referral fees could not occur in other parts of the legal services market. We consider that it is perhaps for economic or cultural

⁶ European Commission, *Council Directive 87/344/EEC of 22 June 1987 on the co-ordination of laws, regulations and administrative provisions relating to legal expenses insurance.*

⁷ *Sawar v Alam* [2001] EWCA Civ 1401 at paragraph 26

reasons that they have not arisen to any great extent elsewhere. In reaching our conclusions, we would of course consider any material evidence of the impact of referral fees in other parts of the legal services market.

Consumers and referral fees and arrangements

2.17 Research by Ministry of Justice published earlier this year tells us that around 34% of people in England and Wales aged 16+ were found to have used legal services in the past three years.⁸ The greatest use of legal services for personal matters in the last three years has been for conveyancing at 50% followed by will writing (27%), probate (17%), family matters (15%) and then accident or injury claims (11%).⁹ Consumers of legal services come into the system via different routes.

2.18 Looking below the surface, the route into legal services is dependent upon the type of legal dispute in question. Table 1 below shows the difference between conveyancing and personal injury across the top three methods of access. It demonstrates that the range of routes into legal services for conveyancing services is fairly evenly spread. However, for accident or injury matters, referral by another organisation is by far the most common route of access.

Table 1 ¹⁰	Conveyancing	Accident or Injury	Total of how all had first heard about their main provider
Recommendation by family or friends	31%	27%	29%
User or family member had used provider before	22%	4%	23%
Referral by another organisation	29%	49%	23%

⁸ MoJ *Baseline survey to assess the impact of legal services reform* MoJ Research Series 3/10 (March 2010) pg 21.

⁹ *Ibid*, pg 7.

¹⁰ *Ibid*, extract from table a3.4, pg 34.

Current regulatory framework

Approved regulators

2.19 Of all the approved regulators, only the Bar Standards Board (BSB) does not allow the payment or receipt of referral fees. The use of referral fees is most prevalent among solicitors (regulated by the Solicitors Regulation Authority (SRA)) and conveyancers (regulated by the Council for Licensed Conveyancers (CLC)). Legal executives (regulated by ILEX Professional Standards (IPS)) are subject to compliance with SRA rules on the use of referral fees. Referral fees are also permitted for Notaries. For those regulated by IPREG (Intellectual Property Regulation Board) and ALCD (Association of Law Costs Draftsmen), referral fees are permitted by omission, since there are no specific rules within their codes of conduct to prohibit them.

Solicitors

2.20 Until 1987, when the ban was lifted, solicitors were prohibited from advertising for business. They were also prohibited until 1988 from having arrangements with third parties for the introduction or referral of business. The Law Society retained a ban on the rewarding of introducers. In 1991, the Solicitors' Conduct Rules were amended in relation to conveyancing to allow contractual referrals between lenders and solicitors.

2.21 In 2001, the Office of Fair Trading (OFT) published its report, ***Competition in professions***.¹¹ In relation to referral fees, it said:

“the current regime...prevents solicitors from making payments for work that is referred to them by a third party. This may be hampering inter alia the development of an online market place that could bring clients and solicitors together. As with advertising, there are welcome indications that this restriction may be abolished¹².”

¹¹ OFT ***Competition in Professions*** OFT 328 (March 2001).

¹² *Ibid*, pg 14.

2.22 In March 2004, the Solicitors' Conduct Rules were amended to allow solicitors to pay referral fees.

2.23 The current SRA rules relating to referral fees (predominantly Rule 9) and arrangements (and by extension those of ILEX Professional Standards) require the lawyer to ensure that the introducer provides the client with information about:

- the existence of the financial arrangement
- the amount of the payment
- the amount paid by the referrer for services
- the amount the client is required to pay the introducer

2.24 In the event that the introducer is breaching any of the terms required by rule 9, the solicitor is to take all reasonable steps to ensure that the breach is remedied. In the event that the introducer fails to comply, the solicitor must terminate the relationship.

2.25 In addition to requirements about client care, cost and complaint handling, solicitors are required to alert the consumer to the following:

- the existence of the financial arrangement
- the amount of the payment
- the amount paid by the referrer for services
- the amount the client is required to pay the introducer
- a statement that advice will be independent and that the client can ask questions
- that information will not be disclosed to the introducer, unless the client agrees
- if the lawyer is acting for the introducer in the same matter, they may need to cease acting because of a conflict of interest

2.26 The SRA is currently consulting on a new code of conduct, which will focus on outcomes and which include provisions relating to the issue of referral fees and arrangements.

Licensed conveyancers

2.27 Rules governing licensed conveyancers require the interests of consumers to be paramount (unless the law or rules require otherwise). Licensed conveyancers are required to tell consumers, in writing and as soon as it is known, about the existence and amount of money that is payable by or to the licensed conveyancer, arising directly or indirectly from the consumer's instructions. Licensed conveyancers are also provided with guidance that requires consumers to be informed about the existence of arrangements for introduction and any sum to be paid in connection with the introduction.

Notaries

2.28 Most notaries are also solicitors and consequently are regulated by the SRA. These notaries will follow the SRA's rules regarding the operation and disclosure of referral arrangements. However, a small number of notaries are solely regulated by the Faculty Office. These notaries, in addition to carrying out notarial activities, are also able to offer conveyancing and probate services, and are allowed to enter into referral arrangements or other introductory arrangements. The Faculty Office has made rules (Rule 13 of the Notaries Practice Rules 2009) to compel notaries to disclose the existence of any referral fee and the notary must also obtain written approval from the client about the arrangement and ensure that their independence is not hampered by the existence of any arrangement.

Barristers

2.29 Referral fees are explicitly banned under rule 307(e) of the Code of Conduct which states that barristers must not:

"Make any payment (other than a payment for advertising or publicity permitted by this Code or in the case of a self-employed barrister remuneration paid to

any clerk or other employee or staff of his chambers) to any person for the purpose of procuring professional instructions.”

2.30 Public Access barristers are permitted to pay to advertise on a website, as long as potential clients generated by the website can contact them directly. Also, clients can pay money to be introduced to a public access barrister, provided no money changes hands between the public access barrister and the referral company.

Introducers

Claims Management Companies

2.31 CMCs are regulated by the CMR whose rules are called the Conduct of Authorised Persons Rules (CAPR). Client-specific rule 8 requires that where business is introduced to a solicitor, the business should not act in a way that would put the solicitor in breach of the rules which govern the solicitor's conduct. Rule 11 requires a CMC that has a contractual relationship with a client to provide, in advance, information about any referral fee or other financial arrangement paid in respect of introducing the claim. The CMC must also inform the client about any relationship with a particular solicitor or panel of solicitors.

Estate Agents

2.32 The Estate Agents (Provision of Information) Regulations 1991 require an estate agent to inform a seller about services which a third party might offer and from which the estate agent would derive a financial benefit. This includes commission or any performance-related benefit and does not apply to buyers. This must be done in writing ahead of agreeing to act.

Insurers

2.33 There are no specific requirements relating to the receipt of referral payments from legal service providers.

Trade Unions

2.34 Trade unions are exempt from the requirement for authorisation under the Compensation Act 2006 in respect of services provided to their own members (or retired members). The exemption is granted on the expectation that they act in accordance with the Code of Practice for the provision of Regulated Claims Management Services by Trade Unions.

2.35 The code of practice requires any referral fee received by the trade union to be disclosed and members to be informed about any relationship that has a direct bearing on the handling of a claim on behalf of a member. They must also be told about the involvement of any subsidiary companies in handling a member's claims. Information given to members about the arrangements with third parties should be clear and appropriate to the members' needs.

3. Views on referral fees

- 3.1 Concerns about referral fees and arrangements have been raised with the LSB by a range of bodies inside and outside of the legal services sector. Calls for specific examination of this issue have also been raised in other regulatory investigations, most notably by Lord Justice Jackson in his Review of Civil Litigation Costs¹³ and by the OFT in its investigation into Home Buying and Selling.¹⁴
- 3.2 In our first business plan, payment of referral fees was identified as an issue that we would be likely to invite the Consumer Panel to consider in order to support development of our thinking¹⁵. We said that we were sympathetic in principle to the views of some stakeholders, including those of The Law Society and SRA, that there was a need for a consistent regulatory approach to the matter.

Bar Council

- 3.3 In June 2009, The Bar Council wrote to us about referral fees operating across publicly funded criminal work¹⁶. The then Chairman of the Bar Council expressed concern about the payment of referral fees by solicitor advocates for Crown Court advocacy work, in particular: (a) the “inequality on which barristers and solicitors compete for work” on chambers and in particular the availability of pupillages; and (b) the compliance with the regulatory objective covering professional principles and the requirement to act with independence and integrity and in the best interests of clients. We were asked to take action on the issue.
- 3.4 In July 2009, The Bar Council made further representations to the SRA, emphasising its concern that the payment of referral fees by solicitor advocates “*clearly undermine the instructing solicitor’s duty to act in the client’s best*

¹³ Right Hon. Lord Justice Jackson *Review of civil litigation costs: final report* (December 2009)

¹⁴ OFT *Home buying and selling: a Market Study* OFT 1186 (February 2010)

¹⁵ LSB *Business Plan 2009/10* pg. 13

¹⁶ Letter from Bar Council to LSB 10 June 2009

*interests, compromise the instructing solicitor's independence giving him a financial interest in the choice of advocate, diminish the public trust in the solicitor and the profession and are liable to undermine the proper administration of justice."*¹⁷

The Law Society

3.5 The Law Society wrote to the LSB at the end of 2008¹⁸ suggesting that we examine the way in which referral fees operated within the legal services market in order to establish whether they operate within the public interest. Further representations were made in November 2009¹⁹ following a resolution by The Law Society Council, which concluded that the way in which referral fees operate within the legal services market is detrimental to the public interest. The Council also resolved that the payment of referral fees tended either to increase the cost of legal services or to put pressure on the quality of the services delivered. The Council's representations suggested that a lawyer's reliance for business on a small number of introducers could undermine his or her independence, particularly where the introducer's interest may diverge from the client's. Members of the Council highlighted the fact that the solicitors' profession was unusual among legal professions internationally in allowing the existence of referral fees.

3.6 As a consequence of these resolutions, The Law Society invited the LSB to examine the impact of referral fees on legal services with a view to prohibiting them across the legal services market.

Office of Fair Trading (OFT)

3.7 In February 2009, the OFT launched a study into the home buying and selling market, publishing a report in February 2010.²⁰

¹⁷ Letter from Bar Council to SRA (copied to LSB) 29 July 2009

¹⁸ Letter from The Law Society to LSB December 2008

¹⁹ Letter from The Law Society to LSB 10 November 2009

²⁰ OFT

- 3.8 The investigation examined the following factors: the level of competition between estate agents on price and quality; the extent to which new business models have developed; whether the existing regulatory framework provided the right balance between protecting consumers and ensuring that the market remained open to competition and innovation; and the relationships between estate agents and ancillary service providers, such as mortgage brokers, surveyors, solicitors and other professional advisors.²¹
- 3.9 It also examined the importance of ancillary services to estate agents, the impact of referrals on choice and competition and how referral fees may affect estate agent behaviour²². It discussed whether existing consumer protections are sufficient to address problems that might result from the payment of such fees to estate agents and considered possible remedies.
- 3.10 The OFT found that the majority of consumers were aware that they could purchase ancillary services directly; that many consumers choose to purchase these services though their estate agent was not, of itself, a cause for concern. First time buyers were more likely to be offered or to act on ancillary services offered by the estate agent, suggesting a need for consumer education, but there was little scope for a specific initiative in addition to that which was already provided.
- 3.11 The OFT research, produced as part of its market study, suggested that there was a potential for conflicts of interest to be created with estate agents earning income from ancillary services sold to buyers. Indeed, this was more than a theoretical risk. A number of possible remedies exist including banning payments outright, though OFT had insufficient evidence to judge what type of remedy would be proportionate. However, it recommended that Government consider a statutory response to the issue, potentially as part of a broader study into the regulation of estate agents.

²¹ Ibid, pg.18.

²² Ibid.

Review of Civil Litigation Costs

3.12 In January 2010, Lord Justice Rupert Jackson published his Review of Civil Litigation Costs in which he recommended that referral fees should be banned in personal injury cases. In the event that they were not banned, he recommended that they should be capped at £200.²³

3.13 In reaching this recommendation, he concluded that in many cases referrers passed on cases to the highest bidder, meaning that there was insufficient matching between the particular solicitor and the specific needs of the client – deepening the information asymmetry between lawyer and consumer. The consequence of this was that, on occasions, clients were sent to the wrong solicitor with potentially damaging results. He further concluded that referral fees, in a fixed cost environment, either drove up the level of fixed costs or drove down the quality of service, or else both.

3.14 Sir Rupert's findings highlighted that the practice by before the event (BTE) insurers and CMCs of charging referral fees added no commensurate value to the litigation process. The effect of referral fees had led to some solicitors cutting corners to cover the cost of the referral fee and to make a profit on the case.

3.15 Importantly, his findings highlighted that access to justice had not been denied or restricted prior to 2004 when the ban on referral fees by the SRA had been lifted:

“The availability and identity of solicitors conducting personal injuries work could be publicised perfectly satisfactorily through the internet, through Law Society advertising, through the APIL website and similar means.”²⁴

3.16 In terms of enforcement, Sir Rupert did not accept the argument that a prohibition on payment of referral fees could not be enforced since the vast

²³ Jackson pg.206

²⁴ Ibid, pg. 204

majority of solicitors were *“honourable professionals and would respect such a prohibition, whether imposed by legislation or by rules of conduct.”*²⁵

3.17 Many protest that referral fees risk bringing the profession into disrepute: they are seen to compromise a lawyer’s duty to act in the best interests of the client. Proponents of this view argue that accepting a payment for receipt of work means that the lawyer is beholden to the referrer as well as the client. Implicit in this criticism is that the financial relationship holds more sway over the lawyer than the relationship with the client, regardless of the lawyer’s professional duty to act in their client’s best interests.

Discussion

3.18 Weighed against concerns raised by bodies advocating a ban on referral fees and arrangements are contrary views from those normally outside the sector. Not surprisingly those that receive referral fees (such as estate agents, CMCs and other introducers) suggest that referral payments are an important means by which consumers gain access to justice – using partnerships to link up a consumer in need of legal services to a suitable provider where they previously might have struggled to engage an appropriate service. In these cases, the referral payment is often viewed as a fee for marketing which in turn generates cases where consumers believe that their rights have been infringed. The ability of CMCs to undertake widespread marketing and advertising is considered by many as something currently beyond the reach of many law firms.

3.19 Of course, the consumer voice should not be lost amongst competing claims within the legal services market. To understand the economic impact of referral fees on the legal services market (and thus on consumers) and to hear, directly, the consumer voice, the LSB commissioned research.

²⁵ Ibid, pg. 205

4. Referral fees: evidence

Summary

- 4.1 As we noted at the start of this report, referral fees divide opinion. Yet the evidence from which those divisions derive has been left largely unexplored. We judged it important to ensure that our analysis was founded upon both a deeper understanding of consumer views of referral fees and a proper economic analysis of their impact upon the market. Vanilla Research²⁶ and CRA²⁷ were therefore commissioned to undertake independent research for the Consumer Panel and the LSB respectively.
- 4.2 To supplement this original research we reviewed existing studies and papers. These included:
- Moulton Hall ***Referral arrangements and legal services research report: prepared for the Strategic Unit of the Law Society*** (June 2007)
 - OFT ***Home buying and selling: a Market Study*** OFT 1186 (February 2010)
 - The Law Society ***Practice Standard Unit Report on Themed Visits – Referral Fees*** (July 2006)
 - OFT ***Competition in Professions*** OFT 328 (March 2001)
- 4.3 We also recognised the expertise and experience of the many representative bodies and others that have commentated on the issue. We attended the Consumer Panel’s initial roundtable that helped us narrow the issues, highlight possible areas for deeper investigation, and read the submissions to its call for evidence. We received correspondence and submissions from a range of professional and regulatory bodies, which helped shape our understanding and analysis.

²⁶ Vanilla Research ***Referral arrangements research*** (March 2010)

²⁷ CRA ***Cost benefit analysis of policy options related to referral fees in legal services*** (May 2010)

4.4 The Consumer Panel's advice to the LSB, its research from Vanilla Research and our own research from CRA were all published well ahead of us reaching any conclusions. Indeed, once we had brought together the existing research, our original research and the advice of the Consumer Panel we held a further event to identify consensus where possible, disagreement where not and areas of contention. At each stage of our investigation, we have encouraged stakeholders to bring to our attention additional evidence that we have missed or new analysis of our research and evidence.

4.5 This thorough and transparent approach has ensured that we can be confident in the evidence that underpins the proposals in this paper. It has allowed those with strong views, contrary evidence and other comments to have the opportunity to comment on what we have found and present additional evidence to help us complete this investigation. However, we remain open to new evidence and analysis and invite all stakeholders to present any evidence that we have missed.

Legal Services Consumer Panel – Referral arrangements

4.6 In November 2009, we asked the Consumer Panel for their advice on the impact of referral fees on consumers. In May 2010, the Consumer Panel published its set of findings²⁸, with the full advice available on its website at www.legalservicesconsumerpanel.org.uk. The Panel had five main sources of evidence: original research on consumer attitudes conducted by Vanilla Research; the results of its call for evidence which received 71 responses; the CRA report on economic impacts; inputs from its stakeholder roundtable discussion and a review of literature and surveys. The Panel identified three key topics to expose the impact of referral fees on the interests of consumers;

- Do they affect the independence of legal advice or lead introducers to recommend unsuitable providers?
- Do they improve access to justice?

²⁸ Legal Services Consumer Panel *Referral Arrangements* (May 2010)

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

Independence

- 4.7 The Panel concluded that three conditions needed 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. The Panel's investigation showed that law firms were not over-reliant on work coming from a single introducer – the key factor that would create the opportunity for introducers to exert improper influence. Alongside this, an investigation by the SRA had uncovered very few breaches of its independence rules.
- 4.8 The Panel identified a theoretical risk where biased advice arose from the incentives of introducers and consumers being mis-aligned. However, the Panel considered that the evidence did not substantiate these concerns. In personal injury cases conflicts were created by the way in which lawyers were remunerated not by the referral fee itself. The Panel noted that referral fees might exacerbate deeper market imperfections, but the appropriate remedy was to tackle the root cause of the problem, not its symptom.
- 4.9 The Panel did, however, have some concerns over independence. They centred on the operation of closed bids or auctions which meant work was referred to firms paying the highest referral fee rather than on an objective recommendation based on the client's needs. Demonstrating the effect of this, research showed that some estate agents put pressure on consumers to use their recommended lawyer. As a more general phenomenon, in personal injury cases the problem of cold-calling remains and the controversy over whether before the event (BTE) insurers should be able to nominate a lawyer also needs to be resolved. There was also found to be persistent non-compliance with disclosure rules by lawyers and estate agents.

Access to justice

4.10 In the case of conveyancing, virtually all consumers need a lawyer and the Panel's study showed that almost all would find one eventually, although introducers may have the effect of helping them to do so more efficiently. For personal injury cases, introducers were found to be likely 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. The Panel's consumer research showed that people value the activities of CMCs which in itself suggests a positive impact on widening access to justice. However there was an undercurrent of hostility towards the so called "compensation culture."

Competition effects

4.11 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. Consumers do not drive 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. The question that arose was whether introducers would do this on the same grounds as a consumer. The Panel examined this by considering the impact of referral arrangements on quality, price and choice (as reflected in the diversity of the supplier base).

Quality

4.12 Levels of satisfaction with outcomes and service for consumers using introducers were shown to be both high (at over 90%) and comparable with rates applicable to the way in which consumers usually select lawyers. In some cases, investment in IT and case management systems - which the regular flow of work guaranteed by introducer panels makes possible - was shown to have improved standards and led to innovation. There is some evidence of dissatisfaction among personal injury claimants and clients using "factory firms" but this does not seem to have an impact on the outcome of legal advice.

Regulators must ensure standards are maintained above a minimum floor, but, as in all markets, consumers make trade-offs between price and quality.

Price

- 4.13 Concern has been expressed that introducers make easy money for little effort and demand excessive fees from lawyers in order to secure work. If this were truly the case then excessive referral fees would be reflected in the prices charged to clients. However, conveyancing rates charged to clients were actually found to be lower among firms paying referral fees. While insurers have argued that referral fees are excessive, the Advisory Committee on Civil Costs has concluded that claims management companies do not make excessive profits.²⁹

Choice

- 4.14 Alongside the value of avoiding favouring one business model over another, the Panel recognised that a diversity of suppliers has the effect of promoting competition by increasing consumer choice. Notwithstanding this, the increasing amount of legal work allocated via an introducer's panel of law firms was found to raise competition concerns – primarily because there is little change in panel membership and the entry requirements would have the effect of limiting access for smaller firms. The impact of panels on competition should be examined further.

Alternative Business Structures (ABS)

- 4.15 The Panel's advice recognised that any examination of referral fees should take account of probable future developments in the market as well as taking place in the present. It is important to 'future-proof' analysis of referral arrangements as the legal services market is currently in a state of change. From October 2011, the emergence of ABS will allow law firms to be owned by non-lawyers and enable them to deliver both legal and non-legal services.

²⁹ Advisory Committee on Civil Costs, *Guideline Hourly Rates – Conclusions*, 2010

- 4.16 The introduction of ABS will open up the legal services market to greater competition by allowing a wider variety of business and ownership structures and no one has suggested that such structures raise the same issues as referral fees. In many areas, the relationships between introducers and lawyers will change, challenging the existing set of disclosure requirements and rules. Where a firm undertakes both marketing and legal activities, the need to pay referral fees would disappear with such vertically integrated businesses able to strip out some of the costs of reaching and delivering to consumers.
- 4.17 The development of the market will be dynamic and regulators will need to ensure that regulatory arrangements are and remain appropriate. One concern is that if referral fees were banned, it would make it harder for traditionally structured law firms to compete in this environment.

Consumer Panel recommendations

- 4.18 The Consumer Panel has not given referral fees a clean bill of health: the Panel set out specific conditions for their retention. 'Reveal, regulate so retain' summarises their analysis – with the last element depending upon the delivery of the first two. Their conclusions are focused on personal injury and conveyancing and not criminal advocacy.
- 4.19 The Panel suggested that transparency needed to be at a point and in a form that supported the consumer in making informed choices about their legal services. That is likely to include the amount and the parties to the referral fees, and to be at a point before the lawyer is fully engaged.
- 4.20 Regulation is much more than rule making and the Consumer Panel recommended that the retention of referral fees could only happen if any rules (be they expressed as “bright line” rules or outcomes to be delivered for consumers by lawyers) were properly enforced. Mystery shopping, other consumer research and the usual regulatory risk management should form part of this package of regulation.

4.21 The Panel made twelve specific recommendations which are set out in Annex 1 to this paper.

Charles River Associates - Cost benefit analysis of policy options related to referral fees in legal services

Methodology

4.22 CRA were asked to assess the impact of referral fees on the legal services market, as well as to produce an analysis of the impact of six policy options and a review of the range of costs and benefits to be considered.

4.23 CRA are experienced economic researchers. In this research, they used a well-honed technique that has been widely used in other economic impact assessments. It involves applying basic economic theories to a market and developing likely indicators of costs and benefits (or pros and cons) of a particular approach. These can then be tested through analysis of third party data (such as volume and outcomes of claims), interview data (such as how firms actually behave in the market) and other evidence. This allows the analysis to test different theoretical costs and benefits against real world data.

4.24 As well as auditing existing research, CRA undertook an initial programme of interviews with key industry participants to build an understanding of the range of concerns regarding referral fees. In total 42 participants were interviewed across conveyancing, personal injury and criminal advocacy markets. A quantitative survey was undertaken on behalf of CRA by the National Federation of Property Professionals. The final stage was to draw the findings together in a policy assessment presented to the LSB. These findings were split across the main areas of legal services covered by the enquiry – conveyancing, personal injury and criminal advocacy.

Conveyancing

4.25 The CRA findings showed that there is evidence that the choice of conveyancer is determined by estate agents on the basis of referral fees. This has contributed to the trend towards estate agents having panels of conveyancers and national firms and away from choosing to use local firms. This trend had already begun before 2004 (the year in which the rules were changed to allow referral fees) with large firms seeking to centralise referral arrangements and move towards using more formal panel arrangements. Smaller conveyancers who do not pay referral fees often have other arrangements in place with estate agents such as reciprocal referral arrangements regarding probate work or the need for a valuation in a matrimonial dispute or offering hospitality.

4.26 The main findings of the research were that:

- referral fees did not impact the quantity of conveyancing undertaken which is instead based on the number of property transactions and re-mortgages
- competition to access introducer panels has led to referral fees increasing over time from around £50 - £100 in 2004 to £250 - £400 today
- conveyancing fees paid by the consumer have remained broadly constant over time despite rising referral fees
- the available evidence also suggests that the average conveyancing fee for those paying referral fees is lower (at £543) than those who do not pay referral fees (£687). This may reflect that formal arrangements have facilitated investment in technology to reduce the unit cost of the conveyancing process
- there was no evidence that the quality of conveyancing was being reduced. Reinforcing this, Legal Complaints Service data showed there were few complaints regarding referral fees or fee sharing with only 12 complaints over a ten year period

Personal Injury

4.27 CRA found that personal injury is the area of law in which referral fees are most prevalent and where the majority of cases are referred by introducers such as

Claims Management Companies (CMCs), insurance companies (for road traffic accidents) and trade unions (for employer liability cases).

4.28 The main findings in relation to personal injury were that:

- there was clear evidence that lawyers who pay referral fees receive more work than those that do not
- competition to access these panels has led referral fees to increase from around £250 per case in 2004 to around £800 per case today
- the level of referral fees paid today is linked to the services provided by introducers as well as to issues such as economies of scale and bargaining power
- there was no evidence that increases in referral fees had led to an increase in the price of legal services
- there was also no evidence that referral fees are causing consumer detriment through a reduction in the quality of services. It was observed that success rates had remained fairly constant and compensation levels were found to be rising
- consumer evidence has supported the link between marketing and making additional claims which would not otherwise have arisen. The increase in claims has probably led to higher insurance prices although it is difficult to describe this as causing consumer detriment where consumers have valid claims

Criminal advocacy

4.29 Whilst referral fees are not used in criminal advocacy, fee sharing is common and can have similar effects. Clients usually rely on a solicitor to instruct an advocate on their behalf and interviewees agreed that clients were in a very weak position to be able to assess the quality of advocacy services.

4.30 Under legal aid, advocates in the Crown Court are paid through the Advocates Graduated Fee Scheme (AGFS) and a similar scheme applies for litigators (LGFS). Fees for the AGFS increased in 2007 and those for the LGFS fell in

2008 - hence advocacy became relatively more profitable than litigation. The AGFS also brought in the concept of the “Instructed Advocate”, the advocate with primary responsibility for the case.

- 4.31 Interviewees reported that they believed that there had indeed been an increase in the use of in-house advocates over time - although quantitative data was not available to demonstrate this in practice. There were concerns that a focus on profitability caused in-house advocates to be appointed for cases beyond their competency which can adversely impact the defence of the accused. This had arisen in response to the changes to the AGFS and was not a function of fee sharing arrangements.
- 4.32 The lack of a quality assurance scheme meant there was little preventing the use of inexperienced advocates from being identified. However since there were no referral fees involved, this is not a problem that can be related back to their impact in the market, but instead is one to consider elsewhere. The absence of quality measures meant it was not possible to assess the extent of detriment from the use of inexperienced advocates.
- 4.33 There were also concerns expressed that fee-sharing arrangements and a focus on profitability caused external solicitor advocates to be appointed for cases beyond their competency. The greatest impact of this was observed in less complex cases. It was also considered possible that this would lead to a potential reduction of experienced barristers in the future or a change in career paths for advocacy with more in-house advocates and fewer independent barristers.

5. Conclusions: personal injury and conveyancing

Summary

- 5.1 We have concluded that there is no compelling case for a ban on referral fees in personal injury or conveyancing, nor evidence that other consumer facing markets should be treated differently.
- 5.2 However, there is evidence that the disclosure arrangements do not always work effectively. Disclosure is a crucial part of ensuring that consumers know the details of the deal they are getting. Yet there is evidence that, in many cases, these rules are not complied with. The disclosure and compliance problems identified exacerbate information asymmetries and other complexities in the legal services market – having the effect of undermining confidence. We believe that these problems require regulatory intervention to underpin consumer confidence.
- 5.3 Below we set out how we have reached these conclusions, with a specific focus on quality, costs, competition, independence, choice and access to justice. We believe that these represent the most important themes for assessing the impact of referral fees within the legal services market. We reached this view after analysing our regulatory objectives (as set out in Section 1 Legal Services Act 2007). You can read our interpretation of the regulatory objectives at http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf.

Quality

- 5.4 Concern has been expressed that the existence of referral fees – particularly in a fixed cost environment, such as personal injury - is likely to jeopardise the quality of the service provided. As total income is fixed for each case, higher referral fees increase a lawyer's costs. The specific concern is that to maintain income levels, lawyers are forced to reduce their effort on individual cases. It has been suggested that this alleged reduction of effort and input from lawyers leads to poorer outcomes for clients.
- 5.5 Concerns over the independence of lawyers and the emergence of any conflicts will have a direct effect on the ability of the lawyer to represent the interests of the client. In judging whether independence has been compromised by the payment of referral fees, thus impacting on quality, we would expect to see evidence that providers are acting in the interests of third parties.
- 5.6 If this were the case, we would expect to see some evidence of consumer detriment where referral fees are in place. This might be in the form of higher levels of complaints, lower success rates or a reduction in the amount of damages awarded across a swathe of comparable cases. CRA's analysis found no reduction in the proportion of road traffic accident (RTA) cases won following changes that removed the ban on referral fees for solicitors. Moreover, claims payments for bodily injury in motor claims have increased since 2001 - and more significantly since 2004 when the ban on referral fees for solicitors was lifted.
- 5.7 In the area of conveyancing, it has been argued that "commoditisation" has led to a reduction in quality. Commoditisation is considered a consequence of increased use of referral fees since it is only by "commoditising" the work involved that firms can continue to make profit. Commoditisation usually means work being undertaken by those without legal qualifications. Lawyers will generally oversee the work and sign it off, taking responsibility for the accuracy and quality of the work undertaken.

5.8 We wanted to see whether there was any evidence that the quality of work or service delivered was poorer in cases where referral fees were paid. Examining complaints, CRA found no evidence that work conducted by those conveyancing firms paying referral fees generated a greater proportion of complaints than work conducted by those who do not pay referral fees. Information from the survey undertaken by CRA suggests that, in fact, those firms which pay referral fees completed conveyancing work in the same amount of time or faster.

5.9 Significantly, the Consumer Panel's findings reported evidence that, in some cases, the investment in IT and case management systems which flows from engagement of introducers has actually improved standards and helped facilitate innovation³⁰. There was also evidence elsewhere that introducers themselves were keen to ensure quality, insisting on service level agreements with the lawyers on their panels³¹. Therefore we conclude that the existence of referral fees or arrangements has not affected the quality of service received by consumers.

Costs

5.10 Another ground for challenging the impact of referral fees is that they have driven up costs for consumers. In examining the evidence, it is important to note that experiences in the personal injury and conveyancing markets are different and need different analysis.

5.9 First, a caveat. In the personal injury market, concern around price is likely to be mitigated by the impact of conditional fee agreements (CFAs or "no win, no fee") and other funding models. Indeed, the majority of personal injury cases do not involve any self-funding. Research by the Ministry of Justice showed that only 6% of consumers funded their own accident or injury legal action with 4% funding in other ways.³² The remainder had their case funded for them either

³⁰ Consumer Panel para.1.26

³¹ Moulton Hall *Referral arrangements and legal services research report: prepared for the Strategic Unit of the Law Society* (June 2007) pg.33

³² MoJ pg.31 table A3.1

through their insurance company (42%), through a CFA (39%), by their trade union (6%) or by legal aid (6%).

- 5.10 In the personal injury arena referral fees have increased from around £250 in 2004 to £800 in 2009³³ and appear to have stabilised since then. The amount of costs that can be recovered in road traffic accident cases is prescribed for cases with a value of £1,000 - £10,000 - placing a natural cap on the level that referral fees can reach.
- 5.11 There is some evidence that firms which choose not to pay referral fees, in some cases, use this as a marketing opportunity. The way they do this is to make a virtue out of not paying a fee to an introducer, meaning that they are instead able to “share” the fee with the client if they decide to take the case up, regardless of whether the case is successful.
- 5.12 In his review of civil litigation costs, Lord Justice Jackson proposes that success fees and after the event (ATE) premiums should no longer be recoverable from defendants. Lawyers would still be able to agree CFAs with their clients but any success fee would be payable by the client. In practice this is likely to mean that the success fee would come out of damages awarded to the client. He also proposes that awards of general damages be increased by 10% and that the maximum amount of damages lawyers can deduct for success fees be capped at 25%. The effect of this would be to give consumers a stake in the cost of the legal transaction which is currently absent from personal injury cases. While it may also create the scope for increases in referral fees, it is also an opportunity for lawyers to compete for clients by asking for the lowest success fee. This issue will be subject to consultation by the Government in the autumn.
- 5.13 Price is much more important to consumers of conveyancing since they will, on the whole, fund the transaction themselves. Research produced by the Ministry

³³ CRA pg.6

of Justice shows that 99% of consumers using a conveyancer had paid for the matter themselves or with support from members of their family³⁴.

- 5.14 In the context of conveyancing, evidence shows that the level of referral fees has increased from around £50 in 2003 to £250 - £400 now. In developing these findings, CRA compared the level of conveyancing charges in respect of those firms who pay referral fees with those firms which do not. Findings indicated that those paying referral fees had a lower conveyancing charge, at £543 on average, than those who do not pay the fees, which charged an average of £687. There are likely to be several explanations for this price differential, though we believe that the most likely reason is that firms undertaking large volumes of cases had greater financial certainty, allowing for more investment in systems and processes that helped reduce the costs (but not the quality) of conveyancing.
- 5.15 The conclusion from this is that there is evidence to support the assertion that referral fees have made a contribution to keeping costs down for consumers. In relation to conveyancing, costs are lower where referral fees are paid than where they are not. Whilst cost is less of an issue in the personal injury arena, this may change with proposals to remove the recoverability of success fees and ATE premiums. These changes will require firms, in a sector that is already competitive, to become more price sensitive in the way in which they compete for consumers.

Competition

- 5.16 We have heard concerns that referral fees mean that work now only goes to large firms – distorting competitive pressures in the market to the detriment of smaller firms. The Consumer Panel expressed concern in their recommendations that the gravitation of conveyancing and personal injury work to large panels raised competition-related concerns which should be examined by the OFT. Specifically it is argued that there is little change in panel membership and the entry requirements limit access for smaller firms; this

³⁴ MoJ pg. Table A3.1

could lead to a small number of firms dominating the market. To reinforce this, they cited the contribution of a respondent to their call for evidence:

“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.”³⁵

5.17 Examining this in more detail, data provided by the SRA to the Consumer Panel shows that the payment of referral fees accounts for up to 20% of the income of just under 70% of law practices that pay referral fees.³⁶ The data also showed that larger firms (43%) are more likely than sole practitioners and firms with two to four partners (16%) to pay referral fees.³⁷ These findings are supported by the results of research carried out by Moulton Hall for the Law Society in 2005.³⁸

5.18 The regulatory objectives require that we encourage a strong, diverse and effective legal profession and that we promote competition in the provision of legal services. Service providers should be free to respond to commercial pressures, confident that regulation will only restrict them where it is consistent with the regulatory objectives and better regulation principles. The driver for increasing diversity is to ensure that the provision of legal services better reflects the community served by the profession – meaning that lawyers are better placed to understand the needs of different types of consumers. However, in the commercial landscape, we believe it is for the market to determine the structure, rather than it being the job of regulators to ensure the viability of individual types of legal practices – with the caveat that this will need to be reconsidered in the face of any reduction in competition and consumer choice.

³⁵ Consumer Panel para.6.59

³⁶ Based on analysis of table 3 in Consumer Panel Advice

³⁷ Ibid table 1

³⁸ Moulton Hall pg. 6

- 5.19 The Consumer Panel recommended that Approved Regulators should consider prohibiting firms from entering into bidding auctions or similar processes for referred work. Since we have found no evidence that referral fees have led to consumer detriment, we believe that it would be inappropriate to consider banning these types of arrangements.
- 5.20 The introduction of ABS will open up the legal services market to greater competition by allowing greater variation in ownership structure. For example, an introducer might become an ABS. Alternatively a law firm may seek to undertake introducer work and market more effectively to consumers. This will enable law firms to compete more sharply with introducer companies. Law firms may also be able to capture some of the introducers' margin and use this additional revenue to invest further in systems and processes. Such investment has the potential to lead to reduced costs for consumers and increase the potential for profitability for investors.
- 5.21 It is important to note that, in practice, some of these business models already exist. Since 2000, CLC rules have permitted the external ownership of licensed conveyancing firms. Illustrations include Countrywide Conveyancing, which is owned by Countrywide PLC, as well as Premier Property Lawyers, which is owned by My Home Move. Such a phenomenon also exists in part in the solicitor market: The InjuryLawyers4U alliance is co-owned by a range of solicitor firms. ABS will allow these models to develop and expand, making the business case for the existence of referral fees increasingly redundant. The development of the market will be dynamic and regulators will need to ensure that regulatory arrangements are and remain appropriate.

Independence

- 5.22 Some of the most consistently deployed arguments against referral fees are based on the assertion that they compromise the independence of lawyers. The suggestion is that the weight of the bargaining power of introducers means that lawyers who pay referral fees can no longer be deemed able to act exclusively in the best interests of their clients – and that conflicts are therefore likely to

arise. In its analysis, CRA found no evidence that lawyers were not acting in consumers' best interests – judging that such evidence would have manifested through higher levels of complaints, higher prices or reductions in quality indicators such as success rates and damages levels.

- 5.23 It may well be the case that introducers are in a stronger negotiating position because they control the allocation of consumers to firms. However, analysis of SRA data shows that there is no evidence that law firms are significantly reliant upon referred work. As we have said previously, in just under 70% of law practices that pay referral fees, they account for below 20% of income. In only 14% of practices that pay referral fees do 'paid for' cases make up more than 50% of income.³⁹
- 5.24 Since firms, in general, are not reliant upon this work, we do not believe there is strong evidence that the unequal power relationship is sufficiently marked to influence the independence of firms. We also note that the SRA examination of referral fees in 2008 showed that the numbers of breaches of Rule 1 core duties - which require solicitors to act in the best interests of clients - was relatively low.⁴⁰
- 5.25 The Consumer Panel said that the risk to lawyers acting against their core duties was greatest when three conditions were met: an unequal power relationship between lawyers and introducers; consumers' freedom of choice being constrained and the interests of introducers and consumers not being aligned. There are clearly concerns about the potential for unequal power relationships and a failure to align incentives, but, as the Panel also concluded, there is no evidence that this has led to a failure of lawyers to act with independence. As we do not consider there is patent evidence of detriment here, improved regulatory monitoring and more effective disclosure will be proportionate measures to address concerns on this front.

³⁹ See note 36

⁴⁰ SRA pg.5

Choice

- 5.25 A corollary to the issue of independence being compromised by the payment of referral fees is that consumer choice is compromised. The suggestion is that consumers do not get the best lawyer for their needs.
- 5.26 The Consumer Panel found evidence that insurance companies strongly steer or put pressure on consumers to use panel solicitors. The Panel were provided with anonymous examples of situations where consumers were being denied choice. Their findings also highlighted problems of pressure selling by estate agents identified in the OFT's report.⁴¹
- 5.27 As we have said above, CRA did not find evidence that lawyers were not acting in the best interests of their clients. This would have manifested itself through examples of detriment such as increased complaint levels, increased prices or reductions in quality such as success rates and damages levels - providing evidence consumers had not been referred to the lawyer best suited to their circumstances.
- 5.28 The evidence does not support a finding that consumer choice is undermined by referral fees and arrangements. However there should be no barriers (real or perceived) in the way of consumers who may wish to use their own lawyer: consumers should of course not be deterred from shopping around. This means that they should be informed of their right to choose at a point in the transaction when it is still possible for that choice to be exercised. We do not believe that the current disclosure mechanisms which are currently in place protect consumers in this regards and consequently we identify this as an area which needs to be addressed.

Access to justice

- 5.29 Supporters of referral fees often make the claim that referral fees and introducers have improved access to justice. On the other side of the debate,

⁴¹ OFT pg.134

others complain that the fees have encouraged a “compensation culture” - although this argument is perhaps most relevant to personal injury, which is an area that requires consumers to make an active decision to engage with the legal system. Conversely, the majority of consumers buying a property must use a conveyancing service – with this activity generally only ever being undertaken by a lawyer, meaning that consumers will eventually have to find their way to an appropriate person.

5.30 In its advice to the LSB, the Consumer Panel⁴² points to analysis of the English and Welsh Civil Justice Survey that demonstrates that fewer consumers resolve personal injury problems than other types of problem. Over 40% of respondents did nothing or gave up pursuing their problem before it was resolved. Our own research in December 2009 showed that 20% of consumers had been in a situation that might be addressed by legal advice but had not taken it. In personal injury cases, 37% of those who had suffered a slip or trip and 27% of those who had a work accident had not obtained legal advice.⁴³ This suggests an unmet legal need in the area of personal injury.

5.31 The number of RTAs and associated injuries has fallen over time⁴⁴ from just under 250,000 in 1999 to under 200,000 in 2008. Despite this, the number of motor claims made has increased significantly since 2004. This coincides with the removal of the ban on the payment of referral fees by solicitors in 2004. Clearly, referral fees are not the sole cause for the rise in claims. A number of factors may have influenced this: the fact that success fees and ATE premiums had become recoverable; court decisions in 2000-2003 that increased the likelihood of success of future claims; and the introduction of the Fixed Recoverable Costs Scheme which reduced the risk of the costs faced by lawyers, supporting an increase in the number of claims.

5.32 Some observers have noted that CMCs were quick to respond to the opportunities presented by these changes, but overall it is difficult to argue

⁴² Consumer Panel para.5.15

⁴³ LSB *Initial consumer research results* (December 2009)

⁴⁴ CRA figure 16

against the view that they have contributed in making it easier for consumers to identify that they have a claim, need advice and get to an appropriate advisor. This is a view supported by the advice from the Consumer Panel who said that “the marketing and the hand-holding role performed by claims management companies and not-for-profit bodies has widened access to justice.”⁴⁵

5.33 We cannot conclude from this evidence that access to justice is harmed by referral fees. It is indeed arguable that access to justice has been improved.

Conclusion

5.34 In any market, seeking to ban a particular type of transaction is at the most interventionist end of the powers of a regulator. The Act requires that the LSB must have regard to principles under which our activity should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed. The Act also requires that we have regard to any other principle appearing to represent the best regulatory practice. Unless the evidence of consumer detriment with regard to referral fees and arrangements is compelling such extreme interventions should be avoided.

5.35 After consideration of the evidence collected across the themes of quality, price, independence, consumer choice and access to justice, we do not believe that there is sufficiently compelling evidence of consumer detriment to underpin a ban on referral fees and arrangements. It is true that we have identified areas – such as disclosure and its interaction with consumer choice – that are not currently ensuring sufficient consumer protection. However, weighed against this, we have found that referral fees offer some benefits to consumers, particularly in connecting consumers to lawyers in fields like personal injury and thereby widening access to justice. The objective, therefore, should be to allow referral fees and arrangements - preserving their beneficial elements and addressing the challenges they cause to consumers.

⁴⁵ Consumer Panel para. 1.9

5.36 The Consumer Panel has made clear that its support for the retention of referral fees is dependent upon two other parts of the jigsaw: reveal and regulate. Our analysis of the evidence leads us to support this position. Transparency - at both the specific and general level - brings an honesty and openness to referral that builds consumer confidence and we consider that essential. Effective compliance ensures that consumer outcomes are delivered and transgressions dealt with appropriately.

5.37 Regulation is not just about clear outcomes, rules and guidance. To be effective it must also be about the identification of risks to desired outcomes and the close supervision of those legal services that match the highest risk profiles. Our analysis leads us to believe that this is as true with the regulation of referral fees as in other areas.

QUESTIONS
1. Do you agree with our analysis of the operation of referral fees and arrangements?
2. Do you have additional evidence about the operation of referral fees and arrangements that should be considered by the LSB?

6. Conclusions: criminal advocacy

Summary

- 6.1 There is no systematic evidence that fee sharing is reducing quality in criminal advocacy. However the profession and its regulators have not yet put in place any effective measure of quality that allows us to evidence the quality of criminal advocacy. The work underway on a Quality Assurance for Advocates (QAA) scheme should address this. Such a scheme would not only provide the basis for assessing quality but will also, when accompanied by strong regulatory action, ensure that criminal advocacy is at the required standard. Below we set out why we have reached these views.

Advocate and litigator graduated fee schemes

- 6.2 Criminal legal aid is paid, at least in part, through a series of graduated fee schemes. Changes to the Advocates Graduated Fee Scheme (AGFS) in 2007 increased the basic fee to include a number of items which had previously had individual costs associated with them. In particular, the basic fee now included Plea and Case Management Hearing (PCMH) and up to four individual hearings. AGFS revisions at this time also introduced the concept of the Instructed Advocate (IA) who would have primary responsibility for the case. If not already named, the advocate attending the PCMH would become the IA who would take ownership of the case and have the case fee paid to them. One of the main aims of the Legal Service Commission in introducing the IA concept was to reduce its administration costs. At the same time changes were made to the Litigator Graduated Fee Scheme (LGFS). The effect of these changes was to reduce the level of fees paid to solicitors who carried out only the litigation element.

Use of solicitor advocates and in house barristers

6.3 There has been an increase in the use of Solicitor Advocates; in part, this represents an expected growth trend from their introduction in the 1990s. However, it is also a reflection of the incentives from changes to the AGFS and LGFS. There has also been an increased use of in-house barristers rather than external advocates. CRA found that solicitor firms with in-house advocates will typically refer cases to their in-house advocates and only use external advocates for surplus work or where cases were beyond the ability of in-house staff.

Incentives for Instructing Advocates

6.4 Instructing Advocates are in a position where they can use negotiations on fee sharing as the basis for the selection of the Substitute Advocate (SA). A solicitors firm may appoint an external solicitor advocate in preference to an external barrister because solicitors are not constrained by the Bar Protocol. Alternatively, a solicitor firm may choose an SA on the basis of the most preferential fee sharing arrangement – in effect the SA willing to do the work at the lowest price. The market level for fee sharing was identified as 80% of the fee given to the IA.

Bar Protocol

6.5 The Bar Council has adopted the Graduated Fee Payment Protocol. The LSC's guidance on the issue indicated that fee sharing arrangements between members of the independent bar should be as set out in the Protocol. The Protocol sets out details of fee sharing arrangements to be used when more than one advocate is involved in a particular case. From its interviews, CRA said that the Protocol sought to set out fee sharing arrangements which were "fair to all advocates involved in a case."⁴⁶

⁴⁶ CRA pg.58

- 6.6 The Bar Protocol will in general lead to barristers seeking a higher share of the fee than is currently seen as the market level (80%) offered by solicitor advocates. The incentive is then on the Instructing Advocate to avoid advocates who work under the Bar Protocol, who will expect to receive a larger percentage. It should also be pointed out that the Bar Protocol is not mandatory on its members.
- 6.7 The CRA report identified the incentive to avoid the Bar Protocol as a source of concern which could lead to the reduction in the quality of advocacy services. In the case of fee sharing in criminal advocacy there was no systematic evidence that it is reducing quality. However, there is currently no explicit mechanism for quality measurement in place. This should be addressed by the implementation of the QAA scheme which will both ensure minimum quality standards and measure the quality of advocacy services provided. A robust and proportionate quality assurance mechanism for criminal advocates is essential for the protection of consumers and the efficient running of the courts.
- 6.8 A QAA scheme is currently being developed by the Joint Advocacy Group (which consists of the three principal regulators of advocacy – the Solicitors Regulation Authority, Bar Standards Board and ILEX Professional Standards). The scheme will initially apply to criminal advocates, and may be expanded to cover family and civil advocates in the future. The LSB acts as project sponsor and oversees the development of the scheme. The LSB has set out seven key principles for a credible scheme – independence, consistency, differentiation, tailored assessment, compulsory participation, limited exceptions and periodic reaccreditation. The JAG has defined and consulted on common advocacy standards which have now been agreed. It is currently consulting on detailed proposals for the operation of the scheme (see: http://www.barstandardsboard.org.uk/assets/documents/QAA_Consultation_Paper%20final%20version%2010-08-10.pdf). The outcome of this consultation will inform agreement by the end of 2010 about the final design of the scheme. It is expected that the scheme will be implemented in July 2011, with a phased implementation period during which existing advocates can gain accreditation.

Conclusion

- 6.9 The Act requires that we should have regard to the principle that our regulatory activities should be transparent, proportionate, accountable, consistent and targeted only at cases in which action is needed. We need to use these principles as guides to help us in the approach we take to examining an issue which falls within our purview. We do this by ensuring that the work we do is evidence based and proportionate to the risk associated with the issue in question.
- 6.10 The Bar Standards Board has argued to us that there are real risks to defendants, the justice system and therefore the public interest from lawyer to lawyer referral. Were we to accept those risks in theory we would expect to be able to see evidence of consumer detriment in practice, where such practice is allowed. Conflict of interest arising from referring is argued to exist because the litigating solicitor chooses the advocate and the instructed advocate can sub-contract the work further. If this were to be the case, there would be a clear risk to quality. However, there is no evidence that lawyers are consistently putting financial interests ahead of their duties to their clients.
- 6.11 It is our view that the interests of consumers are best protected where competitive markets are able to flourish. We have some concerns that the Bar Protocol might be having effects similar to a price support mechanism. We will further consider its operation with the Bar Standards Board, Bar Council and other criminal advocacy stakeholders during this consultation period to ensure that any such scheme operates in a manner most likely to deliver the regulatory objectives.

QUESTIONS
3. Do you agree with our analysis of the operation of referral fees or fee sharing arrangements in criminal advocacy?
4. Do you have additional evidence about the operation of referral fees or fee sharing arrangements that should be considered by the LSB?
5. In particular, do you have evidence about the impact of referral fees or fee sharing arrangements on the quality of criminal advocacy?

7. Recommendations for improving transparency and disclosure

Recommendation one

Improving transparency and disclosure for consumers

- **The legal provider should disclose to their client the key facts about referral fees**
 - **Whom the referral fee is paid to and for what services**
 - **The value of the referral fee in pounds**
 - **The consumer's right to shop around for an alternative legal services provider**

Recommendation two

Improving transparency and disclosure in the market

- **Approved regulators should collect and publish all agreements between introducers and lawyers**
- **All agreements for referral arrangements should be in writing**

Summary

7.1 Disclosure and transparency help to embed honesty and address information asymmetries. The Consumer Panel recommended that we consider further measures to improve transparency for consumers that would place them “at the heart of referral transactions⁴⁷”. We agree that transparency is important for markets but we are mindful of the limitations of disclosure, particularly in markets that are complex and where consumers make infrequent purchases. Relying exclusively on enhancing disclosure also has the risk of being perceived as a “lazy” policy option because it puts the burden of making a complex market work on the shoulders of consumers.

7.2 Research shows that while consumers are prepared to accept the idea of referrals in other markets, they have concern about their existence in the legal services market. However this concern is significantly mitigated when consumers learn of rules about the provision of information to consumers (with

⁴⁷ Consumer Panel pg 63

particular reference to the Solicitors Regulation Authority Rule 9.2 on disclosure); *“In reviewing the current elements of Rule 9.2 ...views turned around substantially on the promise of transparency”*⁴⁸ and *“To simplify an often complex discussion, if Rule 9 is comprehensively enforced consumers are largely comfortable with them, if it’s not, they are largely uncomfortable with them.”*⁴⁹ Therefore, the protections exist but we have a problem with limited enforcement.

7.3 There is ample evidence from the consumer research that continued disclosure of information about the referral fees is important to consumers and we recommend that transparency and disclosure for consumers should be improved.

7.4 Market confidence in referral fees and arrangements is also important. We believe that greater transparency around agreements governing them will assist in this and will aid general economic efficiency. We recommend that transparency in the market should be improved.

7.5 We have set out our analysis behind these recommendations in the paragraphs below, providing more detail of how they can be achieved.

Recommendation one – Improving transparency and disclosure for consumers

The legal provider should disclose to their client the key facts about the referral fees

7.6 The Vanilla Research report found that disclosure was important to consumers and we believe that it is consistent with our regulatory objectives. Each legal services provider is free to determine the exact process for disclosing the key

⁴⁸ Vanilla Research pg 25

⁴⁹ Ibid, pg 26

information, but we would expect the disclosure to take place as soon as feasible at the start of his or her relationship with the client and in writing. In particular, the legal service provider should disclose:

- *Whom the referral fee is paid to and for what services*
- *The value of the referral fee in pounds*
- *The consumer's rights to shop around for an alternative legal services provider*

7.7 Telling the consumer about the referral fee exposes the commercial relationship between the lawyer and introducer. Being aware that the commercial relationship exists will help the consumer understand the nature of their recommendation and be aware of any potential conflicts of interest. Understanding the size of the referral fee can allow consumers to judge the relative importance of the referral arrangements. We believe that consumers are likely to be more concerned about the total cost of the transaction in making a decision to shop around. But we are persuaded that providing consumers with information about the amount of the referral fee paid would impose minimal additional costs and may improve the competitiveness of the market.

7.8 Despite OFT evidence that 48% of consumers shop around for conveyancing services⁵⁰, the Consumer Panel found some evidence that estate agents can pressurise clients into using their conveyancer⁵¹. There are limitations on the circumstances in which some consumers can shop around: for example, Legal Expenses Insurance can impose a referred lawyer as a condition of the insurance contract purchased. But we believe that ensuring that all consumers are informed about their rights to shop around, explaining when they can and when they cannot choose an alternative lawyer, will promote competition in the provision of legal services and address concerns about potential pressure selling.

⁵⁰ OFT pg 133

⁵¹ Consumer Panel para. 4.28

Recommendation two – Improve transparency and disclosure in the market

Approved regulators should collect and publish all agreements between introducers and lawyers

All agreements for referral arrangements should be in writing

- 7.9 The research by Vanilla Research for the Consumer Panel showed that consumers were instinctively concerned about referral fees in the legal services market. The contractual agreements between a lawyer and introducer are at the heart of the issue of referral fees. They are the evidence of whether or not parties have the intention of acting in the best interests of consumers.
- 7.10 Publishing this information for scrutiny by the market, consumer organisations, and consumers themselves should help to ensure that agreements are structured with consumer interests at their heart. We believe that this level of transparency will aid general economic efficiency, allow for the accurate tracking of trends by regulators and give firms every incentive to consider actively where and how to invest to acquire work in a way which minimises their own costs and so contributes to lower charges for consumers.
- 7.11 Disclosure of referral contracts by firms would involve law firms providing copies of the contractual terms and conditions governing their referral arrangements to their approved regulator. The approved regulator would then publish the terms and conditions. The existence of disclosure of contracts is likely to bring pressure to bear on the terms of the agreements to ensure that they are compliant with professional principles, increasing consumer confidence in the market. Firms may choose to use the information to differentiate their offerings to consumers, increasing competition in the market.
- 7.12 Collecting and publishing all agreements between introducers and lawyers would incur compliance costs, both for the regulators, lawyers and introducers. It also requires that agreements for referral arrangements should be in writing.

We would expect that some may seek to amend their contractual arrangements in the light of the new disclosure requirements. Regulators would need to be able to publish and update all agreements on a website to allow full transparency. However, we believe these new costs would be outweighed by the benefits arising from a more transparent and competitive market.

7.13 We recognise that this is a new policy proposal and something of which there is little or no experience in the legal services market. We welcome views from respondents on how this policy might be effectively implemented and the associated costs. In particular, we want to establish whether there would be any issues regarding commercial confidentiality. We would also welcome views on the frequency with which this information should be gathered, published and updated and the nature of information published. Additionally, we seek views on the costs and benefits of disclosure of contracts in full or via a summary template.

Other options considered and rejected

Removing disclosure requirements

7.14 Disclosure requirements impose costs on regulators, lawyers and clients and should only be used where justified by consumer benefits greater than the costs imposed. It is our view, supported by evidence from the Consumer Panel, that there remains a persuasive case for the retention of disclosure to maintain consumer confidence in legal services.

Standardising disclosure documentation

7.15 We believe that lawyers should be free to disclose the information prescribed in regulation in a format best suited to their clients. We have considered the alternative of requiring disclosure in a format prescribed by regulators. This, in some markets, can have the benefit of helping consumers gain greater familiarity with the disclosure information, facilitating greater shopping around and so enhancing competition within the market.

7.16 The benefits from standardisation are more difficult to achieve in markets where consumers are less frequent consumers and so do not have the opportunity to learn from the standardised disclosure. Given the infrequency of interaction of individual consumers with legal services, and the costs imposed by requiring regulatory standardisation, we do not favour requiring standardised disclosure. We acknowledge that representative or professional bodies may provide a model template for their members and see no regulatory problem with this.

Additional measures

Disclosing to consumers at the appropriate point of the transaction

7.17 The aim should be for consumers to receive information at the point at which it can best aid their decision-making. Unless there is strong evidence that receiving this information more than once brings significant consumer benefit, the intention should be that it is provided only once. Ideally, regulatory disclosure should occur when the consumer is first referred to the lawyer by the introducer. But, the regulation of introducers is outside the remit of the LSB and so we have concluded that regulations should continue to require disclosure by the lawyer. We do not intend to provide guidance to approved regulators that their rules should be changed to remove rules requiring lawyers to enforce disclosure by introducers, if any individual approved regulator considers this appropriate. However, it is important to ensure an efficient and effective regulatory regime and so this may be an issue to be examined when we review our approach to this issue in the future.

7.18 We also acknowledge the recommendation of the Consumer Panel that we should “lead a collaborative initiative to achieve a consistent set of regulatory requirements within and outside the legal sector.”⁵² During this consultation period, we will meet relevant bodies to explore the potential for such consistent regulatory requirements.

7.19 It is our intention to bring together regulators from within and outside the legal services market, consumer representatives and others to explore the potential to:

- *Create a consistent approach to disclosure across the wider legal services market*
- *Develop monitoring policies to discern levels of consumer awareness of referral arrangements*
- *Consider future requirements for disclosure, including whether disclosure by legal practitioners remains relevant in the presence of effective disclosure by introducers*

Conclusion

7.20 We have outlined above our recommendation to improve transparency and disclosure to consumers without going beyond what we consider to be proportionate measures to achieve this objective. The way in which this recommendation can be delivered, which we have also set out, will increase consumer confidence in the market and will protect and promote the interests of consumers. We have also discussed our recommendation for improving transparency and disclosure in the market. Having all agreements for referral arrangements in writing and their publication on an approved regulator’s website can help to achieve this. It will help promote competition because it will aid general economic efficiency and assist innovation.

⁵² Consumer Panel pg.63

QUESTIONS
6. Will the proposals assist in improving disclosure to consumers?
7. Are there other options for disclosure that ARs should consider?
8. What are the issues relating to the disclosure of referral contracts by firms to approved regulators and their publication by approved regulators?
9. How should these issues be addressed?

8. Recommendations for delivering active regulation

Recommendation one

Delivering active regulation

- **Approved regulators should set out their compliance strategy for referral fees and arrangements when setting out their regulatory arrangements**
 - **Approved regulators should publish information about the operation of referral fees amongst their regulated community**
 - **Where compliance with referral fee rules is low, approved regulators should have targets for improved compliance**
 - **Approved regulators should have rules which are, where appropriate, consistent across areas of law with other approved regulators**

Summary

8.1 This paper discusses our proposed approach to disclosure and its ability to increase consumer awareness and confidence, allowing consumers to make their own choices and doing so at proportionate cost. We have shown that consumers are prepared to accept referral fees and arrangements in the legal services market when they learn about the requirement by lawyers to provide consumers with information. It is the fact of this regulation that is a 'game changer' for consumers and it is their confidence that the market seeks.⁵³

8.2 Compliance and enforcement is an important part of promoting and protecting the interests of consumers. However, what is necessary goes beyond this, requiring an active regulatory strategy. It is particularly important in delivering improved consumer confidence, which comes from knowing that lawyers are operating within a professional and regulatory regime that is fit for purpose, adhered to and enforced.

⁵³ Vanilla Research pg 25

8.3 The case for improvements here is clear which is why we recommend the delivery of active regulation for referral fees and arrangements.

8.4 We have set out our analysis behind this recommendation in the paragraphs below, providing more detail of how it can be achieved.

Recommendation one – delivering active regulation

Approved regulators should set out their compliance strategy for referral fees and arrangements when setting out their regulatory arrangements.

8.5 Consumer confidence in referral fees depends upon effective monitoring and, where appropriate, enforcement action, to ensure that regulatory outcomes are delivered. We believe that consumer confidence in the regulatory regime will be enhanced if there is greater visibility of the action taken by approved regulators to ensure compliance with rules. This is more likely to happen where approved regulators have a clear strategy for dealing with compliance which is an essential indicator of an active approach to regulation.

8.6 There are several elements which can assist in the delivery of an effective strategy for dealing with compliance and our analysis for each of them is set out in subsequent paragraphs.

Approved regulators should publish information about the operation of referral fees amongst their regulated community

8.7 We have said that market and consumer confidence in referral fees and arrangements will be supported by transparency of data about how such fees and arrangements work in practice. It is difficult for approved regulators to be clear about the performance of their regulated community without clear information. So, as well as the expectation that agreements become public documents, we consider that regular publishing of market data can support a compliance strategy.

8.8 The Consumer Panel also recommended that we should “*monitor through surveys the impact of referral arrangements on levels of client satisfaction with outcomes and service*” and that “*approved regulators should systematically collect data on referral arrangements.*”⁵⁴

8.9 Some approved regulators already have data on the use of referral fees within their sector. That data has helped us move beyond argument to examine the actual operation of referral fees and we consider that this supports the future publication of data. The publication of information will allow the market to see referral fees and arrangements and test for detriment through analysis and research.

8.10 Approved regulators may wish to work together to define datasets and agree how best to collect and publish relevant information. This is particularly important where particular markets are regulated by more than one approved regulator – such as conveyancing and criminal advocacy. Information that might be considered for publication includes:

- Data on the prevalence and use of referral fees
- Compliance and enforcement performance information
- Measures of consumer confidence and awareness of referral fees and disclosure protocols.

Where compliance with referral fee rules is low, approved regulators should have targets for improved compliance

8.11 We were concerned at the low levels of compliance with the current SRA rules for disclosure reported in evidence to the Consumer Panel⁵⁵. Similarly, a recent report to the Claims Management Regulator suggests that compliance by introducers with their contractual arrangements with solicitors is low;

“At a lower level in respect of consumer detriment, many personal injury cases were passed from introducer to solicitors, sometimes through several

⁵⁴ Consumer Panel pg.63

⁵⁵ Consumer Panel para.8.21

*intermediaries, in ways that contravened the rules governing solicitors' conduct. Commission was often not disclosed and there was no written contract between intermediary and solicitor.*⁵⁶

8.12 Where compliance is low, targets can build confidence amongst consumers that approved regulators take compliance and enforcement seriously. To consumers this is crucial – it means that they can rely upon the regulator to protect their interests in markets that they engage in infrequently and with little information.

8.13 We do not expect that targets would be required permanently. Once consumer confidence had been established and embedded approved regulators would want to review the need for targets in this area, just as they continue to review their risk matrix in other areas as the market develops.

Approved regulators should have rules which are, where appropriate, consistent across areas of law with other approved regulators

8.14 The market for legal services can be complex for consumers to navigate effectively. As we have said above, there are markets which are regulated by more than one approved regulator which can lead to different rules for similar transactions. It is an inappropriate burden for consumers to expect them to be aware of these differences and understand their implications.

8.15 Delivering active regulation requires approved regulators to understand where and when it is appropriate for there to be differentiation in their approach to rules. Where rules directly impinge upon consumers' involvement in the market, approved regulators should have rules which are, where appropriate, consistent across areas of law with other approved regulators.

⁵⁶ Mark Boleat *Claims Management Regulation: Impact of Regulation Third Year Assessment* Ministry of Justice (July 2010) para. 4.3

Conclusion

8.16 We have said that approved regulators need to take an active approach to the regulation of referral fees and arrangements and have set out how this can be delivered. We are confident that this will improve both consumer and market confidence.

8.17 This approach to regulation is one that we believe approved regulators will need to take to the totality of their regulatory regimes over the next five years in light of changes within the legal services market generally.

QUESTIONS
10. Will the proposals assist in improving compliance and enforcement of referral fee rules?
11. What measures should be the subject of key performance indicators or targets?
12. What metrics should be used to measure consumer confidence?

Annex 1: Consumer Panel recommendations

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)