
In a galaxy, far, far away...

With the referral fee system still under review, there are a number of issues practitioners should be aware of

BY PROFESSOR JOHN PEYSNER

So young Skywalker, is it better to have a rigorous policy that doesn't work or one that may not be so good but does work?" Clearly there will have to be a large number of sequels (or prequels) before Obi-Wan Kanobi gets to philosophise on the Law Society's referral policy, but no doubt the debate will still be going on when he does.

Referral fees have been under review for two decades since advertising restrictions were lifted, but their use has come into sharp focus since the introduction of recoverability and the emergence of claims management companies. My interest in referral fees is in relation to litigation. I haven't given much thought to conveyancing since articles when my principal said my brain was not wired properly to deal with it.

In 2000, the Blackwell Committee, of which I was a member, proposed that the Law Society should reconsider its rule that barred payments for referrals in the light of "the activities in the personal injury market of claims management companies and their panel solicitors". This was particularly pertinent as we recognised that although referrals were unlawful, they were in wide use and did not attract disciplinary attention. We were concerned that some companies were beginning to monopolise the market and divert work to a chosen few. We felt that the public interest might benefit from a system that encouraged non-qualified people to refer cases to qualified people rather than doing the work themselves. The concern was that a claims management company would have to settle a case at any cost as once litigation started they would have to hand it on.

A particular concern was that it was apparent that referrals were hidden from the client who had no idea that their case had been bought. This approach has turned out to have been a major own goal for the personal injury industry as not only were clients adversely affected but so were firms and the personal injury brand itself. This has helped to contribute to a panic about the compensation culture, which, no doubt, will be reflected in the forthcoming Compensation Bill.

As recoverability kicked in, referrals moved centre stage and became the hub around which the whole personal injury market operated. From the early development of the personal injury market at the beginning of the 20th century market, the price of any referral had been absorbed by the solicitor and went to the bottom line. As long as the costs were reasonable, insurers would pay them, accepting that marketing costs and the cost of acquisition were included in the global sum. And then along came recoverability. Now the referral fee was both hugely higher but also hidden in the insurance premium that had little to do with insurance and a lot to do with solicitors acting as commission agents for claims management companies. It was a case of the tail wagging the dog. The reasoning of the claims management companies and the solicitors tied in to them appeared to be that liability insurers would simply pay the After-the-Event (ATE) premium, not notice the level of the premium and simply pass everything on to the consumer. This analysis neglected three issues:

1. The competitive nature of the liability market.
2. The possibility that the cost could not be passed on in any organised way over a short period of time.
3. Premium levels appeared on their face to be surprisingly high in markets such as Right-to-Acquire (RTA), where success rates were high and purely speculative agreements were common. Though many liability insurers may not have run ATE books they were, after all, insurers and might have some idea of what a reasonable premium might be.

It seems likely that some claims management companies were taking a short-term view and hoping to earn as much money as possible before floating the companies, making a killing and disappearing over the horizon. Obviously, that option is not available to solicitors, many of whom are now harvesting the bitter fruit of this experience.

I accept that many solicitors felt they had little choice: the traditional referral networks had broken down. If you had an

accident, by the time you got to the pub to chat to your mates about who was a good solicitor you were diverted by that friendly face on the TV or accosted by an orange jacket in the shopping centre. Finally, this pyramid collapsed and when I wrote about this subject in 2002, I pointed out that as referral fees were a fact of life, the referral ban was forcing the practice underground, leading to its emergence in all sorts of unsatisfactory ways.

Subject to review, we now have a system which polices referrals with two features. Firstly, there is the requirement to disclose to the client the amount of the payment made to an introducer. So far so good. The second requirement seems more complicated. The regulatory objective is to ensure that the solicitor is not involved in a referrals arrangement which gives clients misleading or inaccurate publicity or allows for cold calling. Unlike the first requirement, this is not about the relationship between solicitor and prospective client, but about the solicitor monitoring the activity of the referral agent. The rule and the rationale are “(the Solicitors’ Introduction and Referral Code) requires that solicitors be satisfied that the introducer had provided the client with all information relevant to the client concerning the referral before the referral takes place. This is so that if the prospective client has concerns about the arrangement, he or she can go elsewhere without having wasted any time or money, or feel obliged to instruct the particular solicitor. To ensure compliance with the requirement it is suggested that solicitors ask referred clients what information the introducer provided about the referral arrangement”. Further, solicitors are required to procure undertakings from introducers that they are complying with the code and they are expected to make suitable enquiries about the way in which the introducer operates. Obviously, it is sensible risk management to ensure that the business partners with whom solicitors work are ethical. However, are solicitors really in a position to be regulators? History suggests that economic power in this market has been held by the introducers so the idea that the weak can regulate the strong seems far-fetched. There are two possible answers to this conundrum. Either, solicitors organise their own marketing and referral networks so that, when required, they can deal with introducers on stronger terms. Or the introducers, claims man-

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agement companies, credit hire companies or whatever, can be relied on to be organisations of integrity, who stand by their undertaking, for example, not to cold call. Currently, there are attempts being made to organise these companies to operate self-regulation. I am not hopeful that this can work and it is likely that the reserve powers that the government will take in the Compensation Bill to regulate this sector will eventually have to be used.

There is an alternative approach to this problem. To go back to the beginning, abolish referral fees and police the system properly. But I don't believe that this is possible. Personal injury work is now a commodity industry. It shares many of the same supply chain features of supermarkets. Why is it that your favourite products occupy more or less space on the shelves? This is not necessarily a direct response to sales but to the discounts, in effect reverse referral fees, paid by producers to retailers. Unless advertising for personal injury is abolished (as is the position in Ireland and New South Wales), which would be intended to suppress personal injury work, the marketers will tend to lead this market and unless solicitors only advertise collectively, referral fees will remain. The only answer now is complete transparency. As American regulators say: “The best antiseptic is sunlight”. We are not there yet but we do have a half way decent policy that can be made to work better. To move to a rigorous ban that doesn't work is not in the public interest.

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