Referral fees have been the most controversial practice issue of the past five years. Neil Rose traces their history, looks at the current state of the market and asks where it will all go from here.

Very little need be said to emphasise that touting in the legal profession is an evil which, whenever it rears its ugly head, must be stamped out.’ This is a view on paying for work to which many lawyers in England and Wales would subscribe, but in fact comes from a recent ruling of the Natal High Court in South Africa.

It is a sign that referral fees are a hugely controversial issue around the world. Seen by most as a necessary evil, and just evil by others, like the Natal High Court, it is hard to deny that referral fees have not greatly enhanced the reputation of lawyers in the five years they have been allowed.

The headlines tell the story: ‘Lawyers “offer bribes to hairdressers for client marriage woes tip-offs”,’ said the Daily Mail. ‘Medics slam “money for referrals”,’ reported the BBC. ‘Exposed: Insurers’ shame.’ The key thing is that none of those involved in these stories were doing anything against the rules. In the first one, south-west firm Trethowans was given a pounding in the media in 2006 for approaching 300 local businesses and asking them to display cards for the family law team and hand them to clients where appropriate, in return for a £75 referral fee if the case proceeded. It was a hairdresser who brought it to the media’s attention and the coverage spiralled off into misreporting that the firm was asking hairdressers to inform on their customers’ marriage woes.

The second one was probably the first referral fee story to hit the media after the ban was lifted in 2004 – Liverpool firm Higgins & Co was castigated in the press for offering GPs £175 per referral.

The story behind the final headline extends insurers’ shame to lawyers’ shame. The paper reported one instance of someone paralysed from the neck down whose case was auctioned to lawyers for £10,000.

Mixed bag
A Google search highlights the variety of arrangements on offer. The Labour Party has a deal with Derby firm Flint Bishop through Labour Legal Services, receiving £250 per personal injury (PI) case among other services offered. The previous Lord Chancellor, Lord Falconer, spoke out against the ‘financial trafficking’ of cases, but the government has made it clear that it regards the rules around referral fees to be a matter for the profession.

Easier2move quotes £175-300, EzeeClaim4U ‘around £100’, Evolution Legal Service ‘typically’ £400-450, of which £75-150 goes to its introducer, Injury Claims Solutions £600 per month and Contact Law a fee equivalent to 10-20% of the profit costs on the case.
However, some law firms, particularly in conveyancing, are trying their hardest to stand up to the referral fee tide and indeed make a virtue of doing not paying them – Norcliffe & Co in Huddersfield, Bedfordshire firm Woodwards and Liverpool’s Hal Emmet all came up as taking this approach.

RTA110 is run by Flintshire firm Lampkin & Co. On its website it rails at length against what it calls the ‘evil trade’ that is referral fees and asks other solicitors to ‘break ranks’ on the issue. It is highly unusual in not only guaranteeing road traffic accident victims 100% of their damages – nothing new there – but also a further 10% paid out of the costs recovered.

The website of national firm Simpson Millar offers visitors various articles on ‘the truth about personal injury claims’, in which it expresses its distaste for referral fees. Instead, it offers clients a direct £250 cash payment for their cases.

**Market movers**

But despite all this, market talk is of PI market fees moving up and up towards the £1,000 mark, with £7-800 not sounding uncommon any more. According to Solicitors Regulation Authority figures, 18% of firms declared referral arrangements in 2007/8.

Though referral fees are appearing in many areas of law, PI and, to a lesser but growing extent, conveyancing are where they are most prevalent. Law Society-commissioned research in 2007, albeit involving a small sample, found that the average annual PI caseload of firms which paid referrals was 3,500, compared to just 35 for those which did not. In conveyancing, those paying for referrals averaged 2,500 cases a year, five times the number of those who were not.

The PI firms had different numbers of introducers – one had only one, another 60 – with rejection rates ranging from 15% to 50% of cases (The Accident Group had a rejection rate of over 70% of the cases it sent to solicitors). The average fee paid was £600. Respondents said workloads had increased since referral fees, and profits had also generally increased, but only by increasing the volume of work and working more efficiently.

Much of that involved the move towards more factory-style processing, with a relatively small number of qualified staff supervising a larger number of unqualified staff, assisted by technology. But changing processes had helped maintain service levels, respondents said, with some introducers imposing service levels which could actually result in higher standards. At the same time, this volume approach placed a heavy burden on cash flow.

Other impacts on firms of adopting referral fees were increased administration in setting up the agreements, putting procedures in place to keep introducers up-to-date with the referred cases and the investment in and introduction of new technology.

Overall the PI market has changed radically in recent times. Firms no longer have local markets – it is now a national market and clients simply do not walk through the door like they used to.

**Property woe**

For residential conveyancing, few firms had a large number of introducers, whether because the arrangement was forced on them or because they were just dipping their toes into the water. The average fee was £75-125. Unlike in PI, most smaller firms were not reliant on referral arrangements to get business. Referral business represented approximately 10-15% of their overall business – in the main their work still came from recommendation and repeat business.

A number of firms said that in order to get onto an introducer’s panel or to get referrals, they had to charge their conveyancing fee at a reduced rate. The justification was getting more business through the door. As with PI, some of the firms had changed the way they worked, with IT and fewer qualified staff, to reduce overheads.

In general firms claimed not to recoup the costs directly from clients, although some charged referred clients more than they did non-referred, while another sought to recoup costs by trying to cross-sell other services or charging for additional services beyond the very basic conveyancing – such as completing the stamp duty land tax return and for a quicker completion.

**Regulatory reform**

The Law Society Council lifted the referral fee ban in December 2003 after several failed attempts in previous years from those who saw that they were happening anyway on the quiet. Pressure was coming from the Office of Fair Trading (OFT) in particular, which would also be a problem in the event of trying to reimpose the ban.

The OFT said it was concerned the ban may be hampering the development of the market and also preventing solicitors from competing effectively. It suggested the requirements for disclosure and for the introducer to comply with the same standards as solicitors that we now have. In the event the ban was not lifted, the OFT said it would consider whether the ban infringed competition law.

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By this point the society was also under the scrutiny of the Clementi review, where possible anti-competitive practices and the council’s role as both regulator and representative of the profession were very much under the microscope – this eventually led to the split of functions since seen at the Law Society, Bar Council and ILEX.

Having lifted the ban, the society had to persuade a sceptical Master of the Rolls, Lord Phillips, to agree to the rule change. A year after the new rule was introduced, Lord Phillips wrote to the society to say he sympathised with the view that permitting the payment of referral fees was a mistake.

A few months later there was a postal ballot of the profession, in which just over 20,000 solicitors voted 3:1 to deplore the decision to lift the ban. Another opinion poll, this time of the public, found that the strong belief that solicitors act in the best interests of the client was not as strongly felt among those who were referred. Nevertheless, the public did not have strong principled objections to referral fees – not that many knew about them – and there was evidence that the experience of those who had been referred was largely positive.

In time the matter was passed to the board of the Solicitors Regulation Authority (SRA). It first looked at referral fees in September 2006, where it was presented with evidence of considerable non-compliance. Nonetheless, the board agreed that the provisions around referral arrangements were not fundamentally incompatible with the ethical duties of the solicitors’ profession. The fault, it said, lay not in the rules, but in the way some solicitors had chosen to ignore their principles. Changing the rules would make no difference if certain solicitors failed to comply with them, whether through ignorance or wilfulness.
Persistent problems
A beefed-up enforcement programme, and an information campaign, followed, with a full review in December 2007. ‘There is evidence of systematic and persistent problems in solicitors properly managing their relationship with introducers, probably because of concern about potential loss of the flow of referrals,’ a report to the board said.

The board decided on further efforts to improve compliance. When referral fees were next reviewed in December 2008, compliance had improved slightly but there were still numerous rule breaches - the board realised that this was a matter of solicitors acting wilfully rather than out of ignorance.

At the same time, only a small number appeared to involve potentially serious misconduct and in the majority of cases clients’ interests were not being harmed. Most breaches were of the detailed referral fee rule (rule 9), rather than the core duties laid out in rule 1, leading to the possibility that in future rule 9 could be done away with, leaving lawyers to judge their conduct against the core duties.

Only two members voted to work towards an immediate reintroduction of the ban, but several more indicated that they would not rule out such a move at a future stage. In the meantime, the SRA is to put in place a further compliance, enforcement and communications strategy, the details of which should emerge shortly.

The 2008 meeting showed how the board is struggling with these issues. But Alan Kershaw, chairman of ILEX Professional Standards and a former SRA board member, describes referral fees as ‘a fact of real life’ and says they ‘need not in themselves do clients any harm provided everyone knows what they are getting’.

SRA research backs this up - what clients want is transparency. In any case, it is hard to see how a return to an absolute ban could be effectively policed, he says. ‘An attempt to do so would require the deployment of a disproportinate amount of the regulator’s resources, possibly at the expense of more substantial matters, and would be most unlikely to guarantee the stamping out of all such payments and “considerations”. Bluntly, asking for referral fees to go away is like asking for Christmasses to be white again.’

Board games
Reintroducing a ban is also hard to contemplate when there would be a growing number of non-solicitors happy to step into the breach. This is why attention is turning to the Legal Services Board (LSB), which is now formally up and running, although it does not assume its full powers until 2010.

The LSB should not be banned unilaterally from payment of referral fees by solicitors. However, Mr McGrady does receive ‘Nothing beats a personal recommendation, but referral fee schemes have certainly helped to provide greater competition, even if they have not been run compliantly and effectively. However, that being said, I do see the “old-fashioned” referral fee scheme being replaced with an ever-increasing “panel” model approach, which has a revenue stream built into it for the referrer on bulk as it were, so no referral fee as such is applied to an individual client, but a fee is paid for being on the panel.’

ILEX Deputy Vice-President David McGrady explains that his firm prefers ‘clients to come to us by reputation rather than for third-party remuneration. I think the general view is that these tend to be fairly fickle relationships. Also, the Law Society regulations are such that they are regarded as something of an administrative and regulatory minefield’.

Profit sanity
However, Mr McGrady does receive some referral work, ‘more because they needed someone in the Wimbledon area to complete their network rather than out of any desire on my part to get involved in this sort of work’, he says.
He finds that ‘the quality of the referrals is often poor and the screening procedures adopted by the referral agent inadequate’, meaning he wastes time pursuing leads that go nowhere. Then there is the cash flow problem – the introducer usually wants paying up front, whereas solicitors particularly working on a conditional fee agreement can wait for a long time to get paid and recoup the referral fees.

Tony Goff, immediate past president of the Motor Accident Solicitors Society, suggests that firms can sometimes be seduced by the volume of work that introducers can bring through the door. ‘The bottom line is that you need to turn a profit and never has the old adage “turnover is vanity, profit is sanity” been more apposite,’ he says. Firms need reliable data and statistics, including information such as the average life span of a claim, in order to be able to calculate accurately the average cost of running a claim. ‘It is always tempting, if you have a good source of work, to take as much new work as you can afford, but in so doing clog up fee-earners with additional work, which will only lead to delays in settling claims and, of course, lengthen the life cycle of a claim.’

Mr Goff reckons firms should be rejecting more referral schemes than they sign up to. He uses the example of schemes where the referrals are very competitively priced but require the solicitor to use a tied after-the-event insurance product and pay for it up front – a cash flow ‘nightmare’ and a possible breach of the core duty to provide the client with the best advice, including advice on the best insurance policy.

‘It is these tough “conflict calls” which make life difficult for those solicitors who wish to run a thriving personal injury practice in the current climate,’ he says. ‘To what extent are you prepared to compromise your conscience and the SRA rules in order to provide work for your personal injury team? The SRA rules on referral fees are clear and you breach them at your peril.’

**Shifting sands**

As Mr Goff says, referral fees are likely to be with us for some time to come and actually he senses some hopeful signs for lawyers: ‘I suspect the balance of power between solicitors and claims management companies (CMCs) will shift. I have heard that firms have recently had some success in negotiating reductions in fast-track motor referral fees, particularly where they have been able to demonstrate over a long period of time that they are efficient at what they do and also pay referral fees in a timely fashion.’

‘There is also some anecdotal evidence of some CMCs in motor cases being prepared to delay payment of the referral fee, either in full or part, to the end of the case. These are slow-moving changes at the moment, but I sense that the change is gathering pace none the less.’

There are other forces at work too. One is the government’s new claims process for small road traffic accidents, discussions on which are ongoing. Work done under the process will be on fixed fees and in its original consultation paper, the Ministry of Justice said those fees will not include the cost of referral fees.

Unsurprisingly this did not go down well with claimant groups, who argued that referral fees are legitimate costs of the acquisition of cases, some referring to them as marketing costs. The ministry then decided that to lob this particular ticking bomb to the Advisory Committee on Civil Costs when it advises on the levels of the new fixed fees. Mr Goff predicts that ‘it is a pretty solid bet’ that the new fixed fees ‘will land the wrong side of the current predictable fees level’.

But referral fees are already troubling the committee. Issuing recommendations for the 2009 guideline hourly rates (GHR) in December, chairman Professor Nickell flagged up as unfinished business the extent to which referral fees account for the 20-35% gap between the hourly rates charged by claimant and defendant solicitors.

A background paper revealed the Association of British Insurers’ argument that referral fees inflate the GHR above market rates. ‘It was put to us that the claims management industry serves no socially useful purpose, the claimants only need the Yellow Pages to find solicitors and that reducing GHR to the level of fees charged by defendants’ solicitors would eliminate a significant degree of anti-competitive behaviour.’

‘It was argued that solicitors were analogous to plumbers who do not need to advertise on television to compete in the market.’

Noting the counter-argument that the claims management system facilitates access to justice, the committee said ‘these are deep waters... [we intend] to pursue these issues by, initially, investigating the role of claims management companies and other introducers, as well as their profitability and the extent to which they influence legal charges.’

**Close encounters**

The bigger picture is the Legal Services Act reforms and the prospect of alternative business structures. It seems likely that a side-effect of these changes will be the growing importance of size in areas such as PI and conveyancing, which are seen as so-called commoditised services where the benefits of scale and good IT to handle the standardised aspects of the work will bring rewards.

Volume practices such as MTA Solicitors – which has grown from three people to 300 in six years – have gone on the record as saying they are keen to take on external investment to develop a business model that gets them closer to consumers and cuts out referral fees. Speaking at an event recently, Professor Stephen Mayson, head of the College of Law’s Legal Services Policy Institute, predicted that moving from referrers to direct client access could be ‘possibly the biggest disrupter’ to the traditional operation of the legal market in the medium term.

With the AA, Coop, legal expenses insurer DAS and no doubt others poised to join the market, the challenge of getting to the client first is going to be ever greater for traditional law firms – although, ironically, the easy income of referral fees may make some current introducers wary of doing the legal work themselves and stopping the flow of money. A small number of law firms are said to have paid millions to join the panels of certain before-the-event insurers.

These are, as Professor Nickell’s committee says, deep waters, but lawyers resist wading into them at their peril.