SUBMISSIONS TO AUSTRALIAN COMPETITION POLICY REVIEW BY EQALEX UNDERWRITING PTY LTD

We have presented two Submissions[1] to the Productivity Commission's current Enquiry on Access To Justice. Our First Submission has been posted on the Commission's website and our Second Submission will be available there shortly.

The Commission's Final Report to the government is due in September.

The principal theme of our Submissions to the Productivity Commission concerned the lack of competition in the legal services sector of the economy.

The Productivity Commission's remit is not primarily concerned with competition. In our Submissions, we did not have an opportunity of expanding on this area. As the Competition Policy Review Secretariat is considering all areas of competition at the moment, we have added our additional comments in this Submission.

Background

Our comments are from our perspective as a member of the Australian insurance market with diversified commercial interests in addition to insurance including representation in the UK. We have extensive contacts and associations with Australian and international insurers, FTSE 250 companies and with many of the largest Australian and UK law firms.

Our specialist areas are financial services, insurance, legal services and R&D. We are represented in Australia and the UK and our principals are barristers and solicitors who qualified and practised in the UK and also Australia. The writer has overseen some of the largest global insurance claims litigated in the principal insurance markets.

The Basis Of Our Submission

There are 4 areas which we would like to address with regard to competition, the CCA and regulation. These consist of :

1. the Legal Profession Cartel and the lack of competitive pricing of legal services
2. Legal Aid Tendering[2] and competitive neutrality
3. No Win No Fee Agreements : are they misleading and
4. Litigation Funding and a level playing field with insurers

Throughout this document, we refer to the Draft Report prepared by the Productivity Commission in its Enquiry on Access To Justice and released in April 2014 as "the Draft Report". We also refer to the Competition Policy Review as the "CPR" and to the Productivity Commission as "PC".

1. The Legal Profession Cartel

The Draft Report refers extensively to the lack of affordable legal services in Australia. In our Second Submission, we said that legal services are unaffordable because lawyers are uncompetitive.

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[1] *First Submission of Eqalex Underwriting Pty Ltd* 4 November 2013 and *Second Submission of Eqalex Underwriting Pty Ltd* 25 May 2014

[2] See the Draft *Report of the Productivity Commission at Information Request 21.3* at page 668

It has always been a common complaint that lawyers charge excessively : today it is heard regularly from judges, politicians, chief executives of corporations, everyone operating a small to medium-size business and the general public. And yet, nothing is done to change the situation.

The legal profession is subject to the terms of the *Competition & Consumer Act* 2010 (CCA) (amongst a myriad of other legislation) and is regulated by the ACCC (together with many other regulatory bodies).

Both the Federal Court[3] and the ACCC[4] acknowledge that the legal profession operates as a cartel.

Although legal charges remain exorbitant for almost the entire population and lawyers are unwilling to offer competitive pricing, they are said to be compliant with the CCA.

Australia suffers from the paradox of having the most commercialised legal services market in the world with some of the highest legal charges in the world. Is it time to bring the competition laws up to date ?

Pricing, Lack Of Competition & Unaffordability

The pricing of legal services remains stubbornly high in Australia due to lawyers being inherently uncompetitive on pricing.

In general terms, the pricing of legal services remains uniformly high. This uniformity is sanctioned by the existing regulatory structure governing the legal profession at Federal and State levels. In practice, this structure is mostly one of self-regulation.

The uniformity of pricing has the character of a cartel despite the apparent absence of collusion on pricing, price-fixing, boycotts or the other areas of the CCA which relate to anti-competitive behaviour by professionals.

If operating as a cartel is permissible as long as the existing terms of the CCA are obeyed, lawyers are therefore sanctioned to be uncompetitive, to charge inflated amounts, with everyone in the community having to endure this and the economy penalised for it.

Failure Of Self Regulation

All lawyers obviously know what their competitors charge. The legal professional costs system allows comparison of charging rates by members of the legal profession amongst themselves, but not to outsiders such as clients. This creates an artificial barrier to reducing prices or increasing competition.

Costs assessors in law firms, barristers chambers, courts and costs drafting firms are all aware of specified rates, charging structures and what is allowed to be charged within the rules and what is not. However, none of this information is available in an openly comparable form.

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[3] *Competition Law Issues For The Professions* Justice John Mansfield Federal Court of Australia, Paper presented to Nineteenth Annual Workshop of the Competition Law & Policy Institute of New Zealand 3 August 2008

[4] *Professions And The Competition & Consumer Act* ACCC 2011

Most lawyers charge hourly rates and prefer to keep their rates confidential. Many law firms do not openly say how much they charge unless approached for advice.

Lawyers will usually provide a general quotation for their services if requested however the vast majority of barristers and solicitors refuse to work for fixed fees. A minority offer 'alternative' fees ie arrangements other than based on an hourly rate but the resulting charges are still extremely high and in most cases, not much different from hourly charging.

Everyone in the community objects to the use of hourly charging rates but they remain in use by nearly all legal practitioners.

Usually, the entire pricing exercise is vague, long-winded, overly complicated and opaque. As identified in the Draft Report, most retail clients (ie members of the public) do not understand Retainer Agreements, Conditional Costs Agreements or Bills of Costs. Even commercial clients find these documents difficult to follow or to verify the amounts charged.

In our Second Submission to the Productivity Commission, we agreed with the comments in the Draft Report that clients usually do not understand these documents or fail to receive the information they need to work out what they will have to pay.

Nearly all lawyers work on a time-cost basis and once the metre starts running, it is difficult to control the final bill. The outcome when the bill is paid is similarly vague. Any disputes on charging are subject to self-regulation.

Our Second Submission refers to the ineptitude of the complaints system within the existing regulatory framework. Clients' complaints of fraudulent over-charging have in the recent past been ignored due to clients' unawareness of the procedures for pursuing complaints. In the absence of a complaint, regulators do not act.

All of these problems point to the failure of the regulatory system governing the legal profession and the refusal by Law Societies, Legal Services Commissions, Ombudsmen, tribunals or courts (all populated by members of the legal profession) to intervene.

When public knowledge on pricing, charging structures and complaints procedures is either unavailable or restricted, the actual cost of the service remains hidden, is difficult to identify and impossible to negotiate. With no information about the competitiveness of different lawyers, all lawyers behave the same way. This causes prices to remain high and the existing charging system to remain unchanged.

<u>Consumers Unable To Assess Pricing Or Quality Of Service</u>

There is no simplified way of seeing whether a firm of solicitors or a barrister is good value for money because there is no publicly accessible way of comparing what they charge. Legal services directories are used by a minority of commercial clients however even these publications exclude any information about charges. The result is that most lawyers avoid scrutiny on pricing unless compelled to provide specific information about the cost of their work.

Legal professionals are reluctant to do anything which could lead to their charges diminishing. During the past 5 years, the global legal services industry has been consolidating with many law firms merging into larger entities, ironically in order to

become more competitive. Whilst they have achieved greater synergies, broadened their client bases with increased business and substantially reduced their operating costs, their charges continue to increase, rather than decrease. All of this merger activity has had absolutely no effect on competitive pricing, apart from removing rivals.

The Need For Change

Currently, there is no avenue for challenging the legal profession to provide less expensive services. Even when gross over-charging occurs, ineffective deterrents are used by regulators or judges ; politicians are disinterested about changing the status quo ; quangos like Legal Aid are provided with their own funding and are largely unaudited ; law firms and barristers ignore any initiatives for bringing prices down.

At the same time, while charging excessively, the legal profession complains unceasingly that governments are inadequately funding the cost of public legal services for the poor and under-privileged.

The sanctions for over-charging are not enforced independently of the legal profession. In the UK, gross over-charging is treated in the same way as fraud and can be punishable by a term of imprisonment.

In our view, the existing regulatory system is stifling competition. The format and language of Retainer Agreements, Conditional Costs Agreements and Bills of Costs needs to be taken out of the hands of the legal profession altogether and given to an independent authority.

These documents need to be produced with as much simplicity as possible : the legal profession should be doing everything it can to ensure that clients have a crystal clear understanding of what they will be expected to pay, how such payments will be calculated and how those payments will affect the amount which the client recovers in a settlement or damages.

Comparison & Legal Auction Websites

There should be much greater openness on charging as the use of aggregator / comparison websites[5] increases. In Britain, a detailed regulatory review[6] is under way to allow increased comparisons of charging rates. Australia should be monitoring these developments in preparation for the same de-regulation occurring here. The CCA would no doubt have some influence on how comparison websites for the legal profession are operated.

In our Second Submission to the PC, we referred to the usefulness of legal auction websites and of the potential to establish such a service. From a competition perspective, there may also be new areas to consider here.

[5] These are currently a work in progress in the UK and the British regulators are at the moment considering how such information should be presented : see *Full Blown Legal Comparison Websites Move Closer - Are You Ready ?* Legal Futures 16 April 2014

[6] See *Applying the Comparison Website Model to Legal Services* The Law Society of England & Wales September 2011 ; *Comparison Websites* Legal Services Consumer Panel UK February 2012 ; *Legal Price Comparison Websites Begin To Sign Up To Good Practice Standards* Legal Futures 10 May 2013 ; *Roundtable on Access To Data* Legal Services Board UK 4 April 2014

Increased Competition Outside Australia

In 2000, Australia began the global revolution in legal services with incorporated law firms (known as 'Solicitor Corporations'). Since then, they have been copied in a number of jurisdictions. Other countries such as the UK are outpacing Australia in competitive legal services, for example with Alternative Business Structures (ABSs) which were introduced by the *Legal Services Act* 2010 (UK) and the reforms of the UK legal system by Lord Justice Rupert Jackson.[7]

In Britain, the diversity of ABSs, Limited Liability Partnerships (LLPs), limited liability law firms, virtual law firms and many other new structures are moving the cost of legal services slowly downwards and forcing increased competition in the legal sector. (The Productivity Commission Enquiry has been examining some of these.)

In comparison, Australians are missing out on the same types of benefits and savings which are available in other countries using the original Australian model. This is happening because legal services in Australia are uncompetitive.

Outdated Solicitor Corporations

At the moment, Australia has no real market equivalent of the UK's ABSs. Victoria and NSW are the only states to have embraced Solicitor Corporations.

The legislative requirement for such companies requires at least one solicitor or barrister with an unlimited practising certificate to be a director of the company. While this may have been appropriate 15 years ago when this concept broke the mould by converting law firm partnerships into corporate structures, times have moved on.

The UK only requires the appointment of directors in an ABS who are "fit and proper" (ie the same requirement as ASIC for Financial Services Licensees). The boards of ABSs mainly comprise investors.

Why should a company carrying out legal services need to have a solicitor director on its board when any company can employ lawyers in-house to do the work who are not on the board and the effect is the same. This lessens competition by requiring a practising legal professional to be on the board to limit the way in which a company providing legal services must function. Multi-disciplinary corporate law firms in Australia need to move beyond the restrictive control of lawyers while being able to employ them.

Opening Up Competition In the Legal Sector

Whilst we are not proposing to pre-empt what the Productivity Commission will say in its Final Report to the government in September, the fact remains that Australia has taken only minimal steps to widen competition beyond incorporated and listed law firms (and both of these have not resulted in any reductions in charging).

In our view, there needs to be a further evolution in the treatment of cartels within the CCA and by the ACCC so that the legal profession (and other professions) can become more competitive and their services can become affordable.

[7] For an explanation of the background to the UK legislation and the Jackson reforms, see the *Draft Report* and our *Second Submission to the Productivity Commission* dated 25 May 2014.

In one important area - conditional costs and No Win No Fee (NWNF) Agreements, it may be that a regulatory review of this area is required (see section 3. below).

In our Second Submission, we suggested to the Productivity Commission that the Federal government should have a dedicated, open channel within Infrastructure Australia, the Federal Attorney General's Department (AGD), the ACCC or another area of government for actively promoting greater competition in the public and private legal services sectors.

Either self-regulation by Law Societies and Legal Services Commissioners should be abolished and moved to a completely independent authority or a new super-regulatory function should be assumed by an existing Ombudsman.

There needs to be a co-ordinated link-up between governments, independent regulators, the business community and consumers to encourage the legal profession to become more competitive and affordable.

2. Competitive Tendering For Re-Distribution of Community Legal Services Programme (CLSP) Funding[8]

We refer the reader to our two Submissions to the Productivity Commission[9] regarding competitive tendering and Section 21 of the Draft Report.

Our First Submission referred to the lack of competition in the supply of legal services funded by government or available from government entities which, in turn, resulted in inefficiency and higher cost to government. We proposed a remedy.

Our Second Submission agreed with the views expressed by the Productivity Commission that competitive tendering should take place for re-allocation of funding for community legal services.

We suggested to the Commission that any tendering should be on an open market basis to allow both public and private service providers an equal opportunity of offering improved services.

<u>Competition Reform In New Areas</u>

We agree with the comments at page 1 of the Introduction to the CPR Issues Paper : Australia needs to drive productivity growth, particularly in competitive legal services if taxes and unemployment are not to rise further.

We believe that the businesses operated or funded by the Federal, State and Territory governments which supply public legal services are inefficient and unduly expensive for governments to maintain at taxpayers' expense. For shorthand purposes, we will collectively refer to these services as 'Legal Aid'.

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[8] See *Section 21 Reforming Legal Assistance Services of the Draft Report* pp 641, 667 together with *Draft Recommendation 21.4* and *Information Request 21.3*

[9] See *First Submission* generally *and Second Submission* at pages 20 - 23

First Submission : Reforming Legal Aid

During the past 17 years, the Federal government (via both major political parties) refused to fund Legal Aid with a blank cheque demanded by the legal profession, Law Societies, judges and politicians.

This resulted in Legal Aid restricting its services to the poor and under-privileged only. The Productivity Commission estimated that less than ten per cent of all Australians would qualify for Legal Aid assistance.[10] In our view, the true figure would be far less and probably between 2.5% and 5%.

Since 1997, the position has been reached where almost $1BN is being spent annually to help a very small percentage of the population. To achieve this, Legal Aid's network of offices and employees is so extensive that it is the largest legal services employer in the country and rivals the largest domestic law firms. Despite this enormous scale, it has ambitions to grow even larger and constantly complains of being starved of funds. At the same time, the Federal government's austerity budget will result in cuts to expenditure in future years.

We suggested to the Productivity Commission that the Federal government should review proposals from the private sector which could bridge any gaps in funding for Legal Aid. We stated our readiness to submit an Unsolicited Private Sector Proposal to any government in Australia for that purpose.

Second Submission & PC's Proposal For Competitive Tendering

In April, the Draft Report revealed areas of Legal Aid for which no existing need can apparently be demonstrated. In addition, the Commission referred to evidence that the Legal Aid budget had no direct correlation with Legal Aid's cost of providing services.

The Draft Report suggests re-allocating the Legal Aid budget to areas of greatest need and that the historical basis for distributing expenditure between the four pillars of the Legal Aid system be dispensed with, in favour of a new system which could potentially include competitive tendering by Legal Aid Commissions (LACs) and Community Legal Centres (CLCs).[11]

We agreed with the Commission that competitive tendering was worthwhile, subject to full, open market tenders being held : in our view, tenders should not be restricted to not-for-profit organizations, publicly funded Legal Aid entities or those operated by governments. We will save repeating our comments here and instead refer the reader to the latter part of our Second Submissions.[12]

Global Changes Affecting The Legal Profession

We refer the Secretariat to the leading text *"The End of Lawyers ?"* by Professor Richard Susskind of Oxford University[13] which has had a profound influence on the continuing revolution in global legal services which commenced in 2000 with the corporatisation of law firms in NSW.

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[10] Draft Report page 25
[11] *Information Request 21.3 at p.668*
[12] See *Second Submission* pp 20 - 23
[13] *The End of Lawyers ? Rethinking the Nature of Legal Services* Professor Richard Susskind Oxford University Press (2008)

The corporatisation 'experiment' was followed up in Australia with the growth of Litigation Funding and the listing on the ASX by Slater & Gordon in 2007. These events were watched closely in Britain and led to a series of watershed regulatory reviews in the UK including the *Clementi Report* in 2005 and the *Jackson Report* in 2009. In 2010, the ground-breaking *Legal Services Act* (UK) was passed by the British Parliament which allowed the setting up of ABSs (on the Australian model).

During the past decade, the UK has undertaken numerous reforms of legal services regulation which now has a number of entities operating outside of the legal profession and its representative body, the Law Society of England & Wales[14]. Some of these structures were copied from Australia.

Various reform measures have been carried out by the UK of its Legal Aid system[15] which is broader than the Australian version and costs a far greater amount than our own system. Australian Legal Aid employs internal and external lawyers while Legal Aid in Britain uses only external lawyers[16].

The reform of Legal Aid in Britain has been slow but has produced significant savings for the UK government in reducing expenditure by several billion pounds. While this has been going on, there has also been an enormous consolidation process occurring with mergers and acquisitions of law firms and barristers chambers taking place. Some of this activity has involved Australia's Slater & Gordon which is now the largest retail law firm in the UK (and Australia).

In the context of the global changes described above, we believe that legal services in Australia could be improved upon and made more affordable if the government-funded Legal Aid sector was exposed to full, open-market competition. We believe that increased efficiencies could be obtained by competitive tendering and that a large percentage of Australians would benefit from these changes beyond the small minority currently served by Legal Aid.

<u>CPR Terms Of Reference & Key Questions</u>

In our view, if the legislation governing Legal Aid was changed to allow competitive tendering by the private sector, the following benefits would materialise :

i. legal services would be extended on an affordable basis to a large section of low to middle-income earners
ii. all Australian governments would have reduced expenditure on Legal Aid
iii. Legal Aid entities would operate more efficiently and for less cost
iv. increased competition would flow to other government-funded legal services
v. the Australian economy would benefit from these changes

With regard to (i), a large percentage of taxpayers has not received any benefit from Legal Aid since its inception in 1974 despite having contributed towards its maintenance each year. This situation could now be reversed if open market tendering was permitted. In the words of the Issues Paper, this would encourage a net public benefit if greater competition and choice outside Legal Aid was promoted.

[14] These include the Legal Services Board, the Legal Services Commission, the Legal Ombudsman, the Legal Services Consumer Panel, the Bar Standards Board and the Bar Council.
[15] See the *Legal Aid, Sentencing & Punishment of Offenders Act* 2012 (UK)
[16] This changed very recently with the creation of a Public Defenders Office (similar to our own).

Legal Aid's Membership Of The Legal Profession Cartel

As regards (ii) - (v), Legal Aid is as much a part of the legal services cartel as external law firms, barristers chambers, Law Societies, costs assessors, etc : Legal Aid conducts itself as a law firm and operates in exactly the same fashion as other cartel members. In our view, its activities fall squarely within the same anti-competitive behaviour as described in section 1. above.

Legal Aid's refusal to refer casework to any organization other than a law firm approved by it substantially lessens competition or may constitute a cartel restriction.

CPR Key Questions & The National Competition Policy

In relation to the Key Questions in the CPR Issues Paper, we believe that :

(a) there are regulatory impediments to competition in the legal services sector which should be altered or removed[17]
(b) government-provided services (via Legal Aid) could be delivered in a manner conducive to competition while meeting other policy objectives if open market tendering took place
(c) there would be a public benefit in encouraging greater competition and choice in the legal services sector which has substantial government participation in operating Legal Aid and the Australian Government Solicitor

In relation to the 6 elements of the National Competition Policy, we believe that :

1. the supply of legal services by the public sector, not-for-profit entities and Legal Aid is anti-competitive and this should be reformed for the reasons given
2. the legislation governing Legal Aid at Federal, State and Territory levels is restricting competition as it cannot be shown that (a) the benefits of the restriction[18] to the community as a whole outweigh the costs[19] and (b) the objectives of the legislation can only be achieved by restricting competition[20]
3. the Productivity Commission is already addressing the question of structural reform of Legal Aid monopolies to broaden out competition however the Commission's ultimate findings may still be restrictive and anti-competitive if tenders are limited to the Legal Aid sector exclusively
4. if the legal system and Legal Aid are viewed as a form of service 'infrastructure', third party access should be encouraged outside (i) government entities (LACs, CLCs etc) and (ii) external law firms handling Legal Aid work, to facilitate competition
5. the Productivity Commission has been examining the costing of the Legal Aid budget but there is no independent prices oversight of Legal Aid as a government business enterprise
6. competitive neutrality should be promoted to ensure that Legal Aid as a government business does not enjoy a competitive advantage simply as a result of its government ownership

In our view, as the annual Legal Aid budget allocation is a one-horse race, it is unsurprising that Legal Aid entities have been unable to cost their own services as

[17] See Section 1. The Legal Profession Cartel
[18] ie the absence of competitive, open-market tendering under the legislation governing Legal Aid
[19] Draft Report page 646
[20] *Second Submission* page 20

they do not face the usual market disciplines experienced by the private sector. Full, open-market tendering would change this.

Whilst not having to compete for CLSP funding, Legal Aid does not compete on equal terms with alternative providers of the same services. On that basis, Legal Aid enjoys a competitive net advantage over private sector operators by virtue of its government ownership and does not comply with the National Competition Policy.

The services provided by Legal Aid are not conducive to competition : this is evident from the inability to identify the cost of services internally and the sparseness of external law firms willing to undertake casework for Legal Aid. There is no competition : although Legal Aid considers its charges to be among the lowest in the market, these charges are nevertheless within the cartel system which keeps prices artificially high.

Private Sector Competing In The Legal Aid Sector

We acknowledge the principle within the Terms Of Reference that "Government should not be a substitute for the private sector where markets are or can function effectively or where contestability can be recognised."

We believe that the private sector, over time, can ultimately supply some or all of the legal services presently carried out by Legal Aid and eventually replace it. If we were not confident of this, we would not be writing this Submission at all.

We have elucidated on our future approach to some extent in our First and Second Submissions to the Productivity Commission. For reasons of commercial confidentiality, we are prevented from going into extended detail regarding our business plan in this document. In the event that full, open market tendering for CLSP funding is announced, we are ready to do so on a confidential basis.

We can however say that our proposals do not involve commercialisation, corporatisation or privatisation of a government agency : we are strictly interested in submitting a tender.

Our approach is summarised in Professor Richard Susskind's analysis which is still appropriate today despite being 6 years old :

> *"The untutored intuition of many lawyers and legal commentators is that so-called 'low-end' legal service, such as consumer law and Legal Aid work, will not be attractive to external investors or entrepreneurs who are thinking about building new-look businesses. However, from my recent work as an adviser to a private equity firm, I can now see why this common view may be mistaken. In the first instance, consumer law and Legal Aid work together have a value in England well in excess of £10 billion. If we also take into account the likely 'latent legal market', depending on the elasticity of demand, this figure may be substantially larger when legal services become more easily accessible and affordable."*[21]

Limitations On Competition By Legal Aid

Currently, Legal Aid is virtually unaccountable to anyone for its own operations and budget spending. Although it employs internal and external lawyers, it allocates

[21] Susskind p.253

casework on the basis of its own inefficient and expensive procedures. Any external law firm which does not meet its ways of operating is refused access to its clients. Consequently, Legal Aid's expensive ways of operating are perpetuated with external lawyers being required to operate in the same way. This prevents any improvements or savings being made because the system does not change.

Instead of Legal Aid having the sole decision-making power on how to assist clients who approach it for assistance, Infrastructure Australia or Attorneys General departments should conduct a general tendering process and establish independent systems outside the ambit of Legal Aid.

3. No Win No Fee (NWNF) Agreements & The CCA

In our Second Submissions to the Productivity Commission, we commented on the failure of the regulatory system and the inability of clients to understand legal services charges within the context of Conditional Costs (NWNF) Agreements.

We also referred to the changes in the UK after the introduction of the Jackson reforms in April 2013 and how the conditional costs regime in Britain changed at that time to become closer to the Australian conditional costs system. The UK changes prompted a flood of complaints to the UK's Legal Ombudsman (LeO) regarding the operation of NWNF Agreements.

In comparison, Australian clients appeared not to have complained at all[22] when a very similar type of system to that adopted by Britain in 2013 had been operating for over a decade. (We are unaware whether statistics exist regarding complaints specifically about NWNF in Australia during this time. If this information does exist, the Productivity Commission has not been made aware of it.)

This prompts the question why clients in Britain should have complained vociferously about a very similar type of NWNF to that existing in Australia, when Australian clients had not.

<u>UK Legal Ombudsman's Report[23] On No Win No Fee Agreements Post-Jackson</u>

In the above report, the UK LeO referred to his increasing concerns during 2012 - 2013 regarding the operation in Britain of NWNF agreements. The LeO's investigation alone (aside from referrals of law firms to other regulators) caused almost £1M to be refunded to clients for "compensation, fees reduced and costs associated with putting things right for consumers".

The Summary to the LeO's report stated that

> *"(NWNF) agreements can offer customers an affordable and simple solution. Not all the time though - we are seeing examples of very poor service in some of the cases that come to us and have made conduct referrals where service providers have failed to honour agreements with customers or have exploited loopholes in the contracts, with serious consequences for their clients.*

[22] A recent UK survey found that 44% of dissatisfied clients failed to complain about the service they received from lawyers *Annual Tracker Survey : Consumer Legal Services Panel* 29 May 2014
[23] *Complaints In Focus : 'No Win No Fee Agreements'* Report by UK Legal Ombudsman January 2014

> *These raise questions about the way that such agreements are structured and sold. There are signs that these cases may be representative of a wider problem with 'no win, no fee' agreements which, if unaddressed, may lead to significant market issues arising. Some, such as the Committees of Advertising Practice (CAP), have previously warned that the phrase 'no win, no fee' is "potentially misleading, because it can imply that the client will be liable for no costs whatsoever". Its guidance note advises that generally, these agreements should not be used unless the service is genuinely free of cost to the claimant. The Advertising Standards Authority has upheld complaints against firms claiming 'no win, no fee' because, unqualified, it implied the client would be liable for no costs whatsoever."*[24]
>
> *"The use of 'no win no fee' agreements should be monitored and reviewed by regulators to ensure that they do not lead to consumer detriment"* and
>
> *"we raise the question as to whether the 'no win no fee' descriptor of the agreement should be used at all."*

The LeO referred to instances where "the fundamental promise which underpins the marketing of (NWNF) agreements - that the consumer will not have to pay for losing cases - is broken. On occasion, we have also seen consumers who have won their case end up out of pocket."

Apart from the Keddies debacle referred to in our Second Submission to the PC, no statistics or evidence apparently exists in Australia regarding similar cases here.

The LeO's report was prepared at the outset of the new post-Jackson regime to address any problems "before they became prevalent in the industry."

Two areas of specific concern were considered - transfer of risk and unclear terms and conditions. On page 5 of the report below the sub-heading "Understanding the Fine Print", the LeO said that

> *"The manner in which such agreements are marketed and explained is also causing problems. The headline marketing mechanic is the phrase 'no win, no fee', which directly implies that the consumer will not have to pay unless the claim is successful. However, that is not necessarily true: there are circumstances where the consumer will have to pay for losing cases. This raises real questions about whether the phrase 'no win, no fee' should continue to be used….The Agreements themselves are not simple to understand….this places a strong obligation on lawyers to explain the way the agreements operate to their clients - and a particular obligation to highlight the potential risks."*

Some of the cases referred to by the LeO are exactly the same as those unearthed in the Keddies scandal.

<u>The CCA : Is NWNF Misleading or Deceptive In An Australian Context ?</u>

If the UK Committees on Advertising Practice, the UK Advertising Standards Authority and the UK Legal Ombudsman all consider the term "No Win No Fee" to be misleading and that it should not be used, where does that leave the same use of the term in

[24] The LeO report cites the UK CAP and ASA (advertising regulators') directives and findings.

Australia in very similar circumstances as in Britain and subject to the Australian regulatory framework ?

Many law firms including the largest, Slater & Gordon use the term “No Win No Fee” very prominently to advertise their conditional costs services.

The question arises whether the same problems experienced in Britain have gone undetected for a very long period of time in Australia. If they have, why haven’t the regulators here been examining the same problems ?

The questions regarding NWNF agreements are symptomatic of the broader problems arising out of the conduct of the legal profession cartel. These include :

- the failure of the self-regulatory system governing legal services
- the ineptitude of the complaints system
- the absence of any information for consumers regarding risk
- the opaque explanations of costing and billing
- refusal to compete on unaffordable, exorbitant charges
- wrongfully mis-describing NWNF as a no-strings, “free” or “no fee” option

When NWNF with its opaque deductions, hidden charges and success fees is placed alongside the unpalatable alternative of exorbitant charges and up-front payments, is it any wonder that clients jump at the chance of not having to pay enormous fees and overlook the fine print in Conditional Costs Agreements ?

<u>Competition Review Of No Win No Fee Agreements</u>

If NWNF / conditional costs arrangements are considered to be misleading and deceptive under the CCA, would all former and current signatories of such agreements be entitled to a review of the CCAs which they signed, subject to any new regulatory environment requiring clear explanations being given ?

The LeO’s report refers to the UK regulators concerns regarding transfer of risk and the need for clients to understand this fully. If the term “No Win No Fee” was no longer used and it was explained to clients that any new conditional fee arrangement was potentially neither free nor risk-free, how would that affect the risk dynamic for law firms (particularly in regard to adverse costs) and the need for insurance security to cover any risks ? Should all future conditional costs cases be required to have Legal Expenses Insurance in place ?

From an insurance perspective and with reference to our comments in our Second Submission, it is highly unlikely that clients would buy such insurance or that law firms would recommend it to their clients or that insurers would supply it unless the regulatory framework was changed to require its use in all conditional fee cases. If that occurred, the entire matrix on which Conditional Costs Agreements presently proceeds, would change however this may occur whether LEI was used or not.

<u>PC Enquiry & Contingency Fees (UK-Style Damages Based Agreements) (DBAs)</u>

The Productivity Commission has recommended that the Federal government allow the use of DBAs on the same basis as Conditional Costs Agreements ie using the same NWNF approach as at present.

The Federal Attorney General has apparently already refused to do so and according to a recent press article[25] has announced he will convene an advisory panel to examine Litigation Funding, class actions and Plaintiff claims.

Any review by the ACCC regarding the use of the term 'No Win No Fee' or Conditional Costs Agreements might also focus on Litigation Funding and DBAs as the similar contingency NWNF model is used by them.

A review of the conditional / contingency fee sector might not result in the concept being significantly scaled back (unless the Attorney General decides to do so). Leaving to that one side, if the UK regulatory position on NWNF is followed in Australia, changes may be required to the existing regulatory structure governing Retainer Agreements, Conditional Costs Agreements, Bills of Costs, Litigation Funding Agreements and class actions so that from the perspective of the CCA, clients are fully aware of the risks inherent in pursuing claims and of the costs of doing so.

4. Litigation Funding & Conditional / Contingency Fees

Since around 1995, Litigation Funding has operated in Australia subject to minimal regulation.[26]

PC Draft Recommendation 18.2 proposes that Litigation Funders should be required to hold an Australian Financial Services (AFS) Licence, meet "appropriate ethical and professional standards" and their financial conduct should be regulated by ASIC.

The Productivity Commission also recommended that "the Treasury and ASIC work to identify the appropriate licence (either an AFS or a separate licence category under the Corporations Act)….after consultation with relevant stakeholders."

Funders are part of the legal profession cartel and it is in their interest for legal charging to remain high. Their principals and staff are lawyers and they work closely with law firms which charge exorbitantly for carrying out legal work.

Litigation Funders & Risk Indemnification

As part of their basic 'No Win No Fee' model, Funders indemnify their clients for the risk of paying any legal costs in pursuit of their claim or any adverse costs if the claim is unsuccessful.

While the claim is being pursued, Funders often deposit in a nominated escrow account, an amount representing the downside risk on costs. Sometimes, they may obtain insurance to cover these downside risks. However, they may decide to meet the cost of the risk themselves. This can often be the case where no insurance cover is available for risks which are difficult to place such as class actions.

If this occurs, Funders may be acting in the same position as unlicensed and unregulated insurers without the necessary reserves in place as required under the *Insurance Act* or the *Financial Services Reform Act (FSRA)*.

[25] *Class Action Sector Makes A Case For No Win No Fee System* Australian Financial Review (AFR) 6 June 2014
[26] *Draft Report Section 18.2 pp 538 - 550*

These reserves can total between $5M and $500M, depending on the type of business conducted by an insurer licensee.

In addition, insurer licensees are required to have in place an extensive administrative back-up for underwriting risks, processing premiums and paying claims.

The cost of these requirements imposed by the FSRA can often total between $10M and $20M each year as the cost of doing business in the Australian insurance market. Australia is viewed internationally as the most highly-regulated financial services market in the world and the benchmarks imposed by APRA and ASIC are very high.

Litigation Funding started as an insurance-backed concept and was pioneered by HIH. After HIH's collapse, it was marketed by unlicensed operators with access to substantial financial backing. At least two funders are listed on the ASX and the largest Funder's major shareholders are US-based.

If it is the case that indemnification of client risk by Litigation Funders is a standard part of their business model, from a competition perspective, there would be no level playing field between Funders and insurers.

Insurers are subject to high capital costs and strict administrative and reporting requirements. In comparison, Funders may have escaped all of this if they have acted in the same way as insurers by assessing and indemnifying risk and placing reserves to meet claims.

If the Litigation Funding model is based on indemnification of risk, Funders would have substantially benefited not only from being unregulated for so long but also operating in the guise of insurers without the enormous expenses incurred by the insurance industry in Australia.

If the indemnification model is used by Funders, all of them should be able to afford the capital requirements and administration costs which are required to be paid by insurers. In that event, there would be no reason why they should not be subject to the same regulatory requirements from a competition perspective as insurers. Increased competition between Funders and insurers would inevitably benefit consumers. Obviously if Funders regularly obtain insurance cover for all of the risks faced by their clients, then the above comments do not apply.

<u>Competition Review of NWNF May Affect Funders</u>

In view of the LeO's report on NWNF and Funders' contingency costs model, they may need to address any cartel problems of opaque information on terms, conditions and charging, clients' understanding of agreements, risk transfer and indemnification. This could mean that any competition review of NWNF might equally affect Litigation Funders as well as Plaintiff law firms, NWNF claimants past and present and class action participants, past and present.

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10 June 2014

[27] We reserve all our rights in relation to the contents of this Submission.