Ministry of Justice: Extension of the RTA PI scheme – proposals on fixed recoverable costs.

Response by Thompsons Solicitors

January 2013

About Thompsons

Thompsons employs over 700 lawyers in 27 offices across the UK. At any one time we will be running 70,000 claims on behalf of people who have been injured at or away from work, through no fault of their own.

Introduction

In response to the 28 February letter from Jonathan Djanogly we set out our opposition to extending the RTA Portal to claims above £10,000, to employer liability (EL) and to public liability (PL) claims. In that response we provided detailed modelling and data analysis, using our cases, for RTA cases above £10,000 and EL cases.

We carried out similar costs modelling for Sir Justice Jackson's review of civil costs. We provided extensive data to Professor Fenn and have recently updated that data.

It is clear from the costs now proposed that no notice has been taken of the data we and others provided. Nor has our point that claimants should be entitled to counsel's advice if applied for and this should be able to be included as a disbursement. We can only conclude that the consultation exercise launched by the 28 February letter was not done with a view to listening to the views of all parties.

It does not appear in dispute that a decision in principle to reduce fixed recoverable costs, and even perhaps the figures themselves, was made at the private meeting between insurers and the Prime Minister on 14 February. The direction of travel having been set would explain why there is no justification given for our arguments being rejected, why the costs levels proposed by Jackson LJ and the figures calculated by Professor Fenn for unissued cases have been ignored for the portal extension, or why for RTA cases an entirely arbitrary £700 reduction has been applied to the current portal costs of £1,200 for Stages 1 and 2.

This contemptuous approach to independent data is replicated in other proposals. For example, Table B of the Jackson Report has figures for unissued, quantum only EL cases up to £10,000 ranging between £1,525 and £3,100. Yet these proposals suggest, without any explanation or justification, just £900 for Stages 1 and 2.

Because the Jackson tables were modelled on all cases, including those that will now go into the portal – by definition the more straightforward cases where liability is admitted quickly – a reworking by Professor Fenn of the tables to exclude cases that will now go in the portal, would demonstrate that the costs of the remaining cases are higher and require upward revision of the corresponding figures in the table.

We cannot see any evidence of how the Jackson figures have been amended to take account of inflation since the table was produced in 2009. No details are given of what level of inflation has been used and any inflation increase has been subsumed in a more substantial and unjustified reduction to take account of the referral fee ban

In our response to the 28 February letter we set out a reasoned case as to why there should be no reduction in costs as a result of the ban on referral fees. Not only has our detailed explanation of

referral fees and marketing costs been ignored, there is no explanation of what sum is attributed to referral fees or how the figures are calculated.

We do not accept the argument that a ban on referral fees inevitably reduces costs. We set out our reasons below which are further supported by developments since our response to the 28 February letter.

It is also necessary for the department to consider the impact of the amendment to the Health and Safety at Work Act regulations contained in the Enterprise and Regulatory Reform Bill which will remove breach of statutory duty. All the work done on the levels of fixed costs for EL cases has been on the basis that they are pursued and decided on breach of statutory duty as well as negligence.

If in every workplace accident claim the victim must prove foreseeability then the costs in those cases will increase substantially. The government's own impact assessment confirms that removing breach of statutory duty is likely to increase costs in some cases.

More fundamentally, we continue to oppose the extension of the portal and endorse the comments of Professor Fenn that: "There first needs to be a thorough assessment of the likely impact of the proposed level and structure of fixed costs on the way the market works and the extent to which this may have an effect on the number of accidents and claims, as well as damages."

We therefore welcome the justice secretary's announcement of a postponement of the portal extension and call on the department to use this time not just to properly agree with all stakeholders the protocols and rules but also to carry out a thorough and transparent assessment and remodelling of the fixed costs, taking full account of all the issues highlighted above and all the data provided by ourselves and others.

Questions

What are our views/supporting evidence on:

- **The proposed rates and the differential above and below £10k**
- **The proposed differential between RTA and EL/PL FRC rates**

Both rates are too low.

The base costs in RTA cases below £10,000 of £1,200 for stages 1 and 2 came out of an evidence based process that included detailed statistics from all stakeholders, expert assistance from Professor Paul Fenn and were mediated by the Civil Justice Council. There is a £700 difference between that jointly agreed figure and the £500 being proposed. What has changed to justify this?

It is not so much the differential that is in issue, but the figures themselves. It appears that the figures for RTA claims are arbitrary and have been arrived at by a method that is not explained. Different figures have been decided on for EL, again by a method that is not explained.

Detailed analysis of thousands of our cases shows that for Stages 1 and 2 the costs for EL cases should be £2,934 (18 hours x £163 per hour). We offered to share these calculations and the evidence on which they are based with the department when we responded to the 28 February letter, but this was not taken up. We repeat that offer here.

If the fundamental business principle that costs must match the work that needs to be properly carried out – here on an EL or RTA claim but it could apply to any business – is undermined then the quality of legal representation (or product) will be driven down. In personal injury cases the result will be that victims will not have effective representation or equality of arms.

The fixed costs structure agreed for the RTA claims process was not modelled on more

complicated cases over £10,000. The proposed extension requires at least proper re-modelling of the fixed costs and that hasn't been done.

Automatic uprating is also essential as costs fixed today will quickly be eroded by inflation. Appropriate indexation is crucial and equitable and indeed was wholly accepted by Jackson LJ in his Final Report [Chapter 6 (iii) Review of fast track fixed costs para 2.8].

We note that disease cases have been included in these proposed costs, yet there have been no figures from Professor Fenn on disease claims. It would appear that an assumption has been made that disease cases involve the same work as other EL claims. We oppose disease claims being included in the portal. But if they are to be then there must be proper analysis of the work required before any Fixed Recoverable Costs (FRCs) can be arrived at.

Referral Fees

In relation to the proposed FRCs outside the portal it would appear that the insurers' contention that a substantial discount should be applied to reflect the referral fee ban has simply been accepted.

This amounts to acceptance of the insurers' highly contentious argument that hourly rates are inflated in order to pay referral fees, so a reduction in Guideline Hourly Rates (GHRs) will drive referral fees down and, using the same logic, banning referral fees justifies a reduction in FRCs.

This issue was been independently considered by the Advisory Committee on Civil Costs (ACCC) in *Guideline Hourly Rates (GHRs) – Conclusions* in March 2010. We point out the coincidence that this independent advisory body, which did not accept the insurers' position on this issue, has now been disbanded.

The ACCC cited the insurers' case that:

…the very existence of GHRs at their current level enables claimants' solicitors to pay referral fees and that the CMI is, therefore, only able to exist in its present form because GHRs are significantly higher than the "market rate". The argument is set out in detail in ABI (2009), "Marketing Costs for Personal Injury Claims: Evidence of Market Failure", ABI Research Paper No. 15, Report from Oxera Consulting Limited. (ABI (2009)) and we summarise it below.

There are four basic steps to the ABI approach:

i) Conditional fee agreements (CFAs) plus cost shifting (loser pays winner's costs) ensure that there is no pressure from customers to limit claimants' solicitors spending. The basic costs of each PI case for claimants' solicitors are reflected by defendants' solicitors' hourly rates. So the gap of 20-35% between these and GHRs is available for marketing costs including referral fees.

ii) CMCs have bargaining power vis-a-vis claimants' solicitors. As a consequence "the current level of referral fees appears significantly higher than the cost for making such a referral incurred by many intermediaries". (ABI, 2009, p.4)

iii) Marketing costs, in general, and referral fees, in particular, are much higher relative to revenues in the PI sector than in comparable legal sectors, such as divorce and employment tribunals. They are comparable relative to revenues in the wills sector but this is because of the fixed costs associated with marketing and advertising, so they are bound to be relatively higher for smaller value activities.

iv) So if GHRs were reduced, claimants' solicitors could only afford to pay lower referral fees and referral fees would thus fall. This would not cause much of contraction in the market because it would merely cut the excess profits generated by CMCs. They would continue to do the same job, making an adequate return. So there would be a minimal reduction in PI cases entering the legal system and no serious access to justice issues.

The ACCC Report then considered the insurers' case and made two points in rejecting it:

a) The fact that marketing costs are high in PI cases is not, per se, a very powerful argument. Presumably, a key variable here in the total value of extra cases gained from each extra unit of marketing/advertising spend. In ABI (2009), Figure 4, we see that proportional marketing costs for wills and PI cases are a lot higher than for divorces or employment tribunal cases. This is argued to be a compelling fact in the case for the proposition that the PI sector overspends on marketing. However, it is hardly surprising because advertising will get more wills or PI cases into the legal net than divorce cases or employment tribunal cases. Since one cannot get a divorce without entering the legal network, advertising is unlikely to get many, if any, extra cases into the legal system. And a good proportion of employment tribunal cases are moved into the legal system by trade unions, law centres and other advice centres.

As a consequence, there is bound to be a lesser role for marketing/advertising in these cases and a firm specialising in divorce or employment law is liable to spend less on marketing as a proportion of turnover than a firm specialising in wills or PI.

In view of this, there seems little weight to the argument that marketing expenditure by PI firms is excessive simply because it is higher than such expenditure by divorce or employment tribunal firms.

b) A thread running through the ABI argument is that CMCs are making excess profits (e.g. point ii) above). In some sense, if GHRs are "too high", either someone is making excess profits or one/both of the CMI and claimants' solicitors are grossly inefficient. It is not claimants' solicitors, because the gap between their rates and defendants' solicitors rates is entirely accounted for by marketing costs. So it must be CMCs. By making use of the FAME database, based on the published accounts of all limited companies, we gathered some evidence on this question. The majority of CMCs are in two sectors of the 4-digit Standard Industrial Classification (SIC), namely Non-Life Insurance (6603) and Other Business Activities Not Elsewhere Specified (7487). The first sector (6603) contains around a third of larger CMCs with a total turnover of around £800M. For those firms with turnover above the median in this sector, the median profit margin (profits/turnover) of CMCs in 2004-7 is 13.1%. The median profit margin for all firms above median turnover in this sector in 2004-7 is 12.7%. In the second sector (7487), the median profit margin of CMCs is well below that of all firms in the sector. Similar results are obtained using turnover weighted mean profit margins. Overall, therefore, in a large, significant sample, there is no evidence that CMCs are making profits significantly in excess of comparable non-CMC firms.

So CMCs appear to be setting prices at a mark-up on costs which is standard for the overall sector in which they are located. There is no sign of excess profits here. But it could be that CMCs are grossly inefficient thereby dissipating the excess profits. In this case, of course, we may be led to ask why more efficient CMCs do not enter the market and capture the readily available profits on offer.There may be some barriers to entry here but it is not easy to pinpoint precisely what these are. As a consequence, a reduction in GHRs leading to a reduction in referral fees either leads to a contraction of the CMI and hence a reduction in access to justice or it would lead to a more efficient business model in the CMI with only a minimal reduction in access to justice. We are not in a position to discriminate between these two outcomes but we can argue that it is not the job of the ACCC to attempt to manage the industry structure by price regulation, particularly on the basis of an argument about inefficiencies in the CMI which is purely speculative and for which we have no evidence.

We agree with the ACCC.

The insurers' case on GHRs is based on a flawed assumption that the discredited insurance model of high referral fees is the norm in the market and that all other models should be disregarded.

We are the largest employer liability firm in the UK and we do not adopt the insurers' discredited model of inflated referral fees. Our spend on referral fees is only **£39.80** per case. We suspect this will not be untypical.

Relying on others to do the marketing and paying referral fees to them is only one model among many to market for cases and is not remotely the norm. In reality, Thompsons, and other law firms, adopt a mix of a number of the following options:

a. Gaining a High Street presence (for which they will pay a rental premium) and relying on passing trade.

b. Investing in advertising such as in newspapers, TV, radio or on the web.

c. Establishing a reputation for quality by investing more in its lawyers and in training. This is often combined with specialisation in a particular legal field, enabling the firm to work with voluntary and campaigning organisations such as asbestos groups, serious injury charities, trades unions etc.

d. Direct marketing methods such as mail shots or web marketing through search engine optimisation or pay per click campaigns.

Thompsons' main marketing strategy is based on option c – quality/reputation. It is that which delivers trade union clients to instruct Thompsons. Our reputation for recovering the maximum compensation for injury victims was independently verified by the government statistics on the average damages per firm in the miners compensation schemes which, while showing us getting the highest compensation for our clients also highlighted the dangers of FRCs with the vast majority of firms recovering inexplicably low damages.

Thompsons' average damages of £16,379 and £9,202 in the two schemes were significantly higher than other firms. [Hansard 26 Jun 2009 : Column 1201W]

Thompsons has also used direct marketing, with mail shots to union members to encourage them to use the union legal service. One typical example is a mail shot campaign of 120,000 members of a public sector union in January 2010. This cost £41,700 and delivered 177 additional cases – a cost per case of **£236**.

Any firm paying the level of referral fees suggested by the insurance industry would have to invest a huge percentage of its resources in case acquisition rather than on employing and training high quality lawyers. And even if this happened the insurers' case still falls.

On our figures (see our response to the 28 February letter) some 79% of cases fall out of the portal. That means the vast majority of cases result in a recovery well in excess of £1,200. So, to consider the cost of acquisition of cases by reference to an outcome that applies in only a minority of cases, is perverse.

Our position on referral fees in our response to the 28 February letter has been bolstered by more recent developments. The discussion paper on the ban, issued by the SRA the regulator tasked with enforcing it, and the subsequent SRA consultation paper published in October, confirm that, subject to consultation:

- Law firms which advertise direct or incur other marketing costs can still do so. There has never been any suggestion otherwise.
- Law firms which pay for collective advertising, such as Injury Lawyers 4u, can still do so.
- Firms which pay to be on a website panel and then pay for cases from that site can still do so where the site provides clients with the details of that lawyer as the firm they recommend within a specified postcode. It follows that charities or others who receive sponsorship from law firms to be on their panels where they recommend one or more firms to clients can still continue those arrangements.

The proposed changes to the SRA Handbook provide as follows:

7. This means that there will be some arrangements that, whilst not breaching the LASPO provisions, will still be considered a referral for the purpose of the Code of Conduct and will still be

subject to the relevant outcomes. This is because we believe that our wider definition provides important consumer protection by ensuring transparency, and the primacy of the client's interests, in relation to a wider range of arrangements. For example, we consider it important that where a third party recommends a particular firm, the client is aware of any financial arrangement and can make an informed decision about the recommendation.

It is clear from the above that, in addition to advertising and marketing costs, law firms will still be able to make payments to third parties and they will still be regarded as lawful referral fees by the SRA and regulated by them as at present.

Portal Costs and the Jackson Tables

It is instructive to apply a cross check of the proposed portal figures against the fixed costs tables proposed by Jackson LJ in his final report in December 2009 – see Appendix 5, page 539 of that report which applies a discount for early admission of liability.

The Jackson tables were modelled on all cases, including those which will now go in the portal. These are, by definition, the lower cost cases where liability is quickly admitted. An EL case which settles for £3,000 without proceedings would, under Jackson's fixed-costs table, recover base costs of £1,350 plus 17.5% of damages, ie a total of £1,875. The table of recoverable costs needs now to be reworked by Professor Fenn to exclude from the data those cases which will now go in the portal. This will demonstrate that the costs of the remaining cases are higher requiring upward revision of the corresponding figures in the table.

The corresponding figures for cases settling up to £25,000 are:

£5,000 damages - £2,225

£10,000 damages - £3,100

£15,000 damages - £3,600

£20,000 damages - £4,100

£25,000 damages - £4,600

The figure we proposed in our response to the 28 February letter and that we can substantiate by reference to our extensive case data was £2,934. That is considerably lower than the average recoverable costs under the fixed costs proposed by Jackson LJ.

This is consistent with Jackson LJ's comments at page 44 of his final report:

3.6 It must, however, be accepted that however skilfully the rules may be drafted, civil procedure is bound to be complex and the process of civil litigation is bound to be costly. As Professor Dame Hazel Genn observed at the Birmingham seminar, "there appears to be an irreducible amount of work that must be done even to recover damages of £2,000 or less".

The full quotation from Professor Genn's 2009 paper is:

The following figures… show that there is a considerable variation in costs among cases of similar value, and that for low value claims costs are regularly higher than the amount awarded or agreed in damages. This reflects the fact that the amount of work done on a case is a reflection of many factors and there appears to be an irreducible minimum amount of work that must be done even to recover damages of £2,000 or less. [Professor Genn's seminar paper, 26 June 2009, paragraph 10 which can be found at http://www.judiciary.gov.uk/docs/costs-review/analysis-costs-data.pdf]

The proposed portal costs for EL cases are only a fraction of the figures recommended three years ago in the Jackson Report for comparable cases. The comparative figures are:

£3,000 damages - £900 (48% of the costs recommended in the Jackson Report)

£5,000 damages - £900 (40% of the costs recommended in the Jackson Report)

£10,000 damages – £900/£1,600 (29/52% of the costs recommended by Jackson)

£15,000 damages - £1,600 (44% of the costs recommended in the Jackson Report)

£20,000 damages - £1,600 (39% of the costs recommended in the Jackson Report)

£25,000 damages - £1,600 (35% of the costs recommended in the Jackson Report)

Instead of increasing the costs recommended in the Jackson Report to account for inflation over three years, the proposal is to slash them by up to 65% while giving no reasoning and refusing to adopt an evidence based approach.

Further, the approach proposed is in direct conflict with the detailed evidence based findings in the Jackson Report on fixed costs. Jackson took full account of the insurers' contentions on the impact of referral fees. At pages 154 to 159 the Final Report confirmed:

During autumn 2009 the CJC hosted a series of five facilitative meetings (a) between claimant representatives and defendant representatives in relation to personal injury claims …. The meetings were chaired by Michael Napier QC, who is one of my assessors. A substantial quantity of data was assembled and provided by Professor Paul Fenn, another of my assessors, for the assistance of all present. Tim Wallis of the CJC acted as mediator, when required… Bob Musgrove, chief executive of the CJC, was the overall organiser…

Although it was not possible to obtain "industry agreement" on the figures and models presented by Professor Fenn, the contributions made by the parties at the facilitation meetings have given me considerable assistance in reaching my conclusions on fixed costs in the fast track…

At the first facilitation meeting in relation to RTA claims, and in the absence of industry-agreed figures, an important and helpful written agreement was reached by the parties that "the analysis by Fenn of the data provided to him is statistically reliable". This agreement was also a feature of the ELA and PLA facilitations. In the ELD facilitation the wording of the agreement was amended to include the words "subject to the reservations expressed by Professor Fenn himself" (see section 5 below). I have carefully considered Professor Fenn's statistically reliable data…

At the RTA and ELA facilitations it was also agreed that the parties could make additional written submissions on five areas, namely (i) the effect of inflation; (ii) efficiency savings/cash flow benefits; (iii) the effect of referral fees; (iv) escape criteria; and (v) future review of fixed costs/a Costs Council…

The defendant representatives argue that the levels of fixed costs should be approximately £400 lower than Fenn 2 and there should be a further reduction to take account of general efficiency savings. The gist of the defendants' arguments is as follows. The Fenn data must be viewed and adjustments made in light of the new process. No increase is necessary to account for inflation as this is already reflected in GHRs and the current FRC linked to damages levels. Account should be taken of savings to claimant solicitors by a reduction in costs on costs, less management time and better cash flow. Defendants argue that costs should be set to drive an increase in efficiency. A reduction should be applied to reflect the disproportionate referral fee element of current base fees…

On the basis of the present data, I consider that the Fenn 2 figures are the correct starting point. Many of the arguments advanced on the claimant and defendant side cancel each other out. However, two important points stand out:

(i) Claimant solicitors will no longer have to maintain documentation required

for costs assessment or spend time arguing about costs. Thus the hitherto substantial "costs of costs" will be saved.

(ii) A fixed costs regime is bound to generate business process efficiencies in the form of reduced management costs or overheads.

I expect that these two factors will lead to substantially greater savings than the figure of £400 per case, which is allowed in Fenn 2. Nevertheless, these are matters which can be reviewed in due course by the Costs Council. For the time being, I recommend that the Fenn 2 figures are used as the basis for fixed costs, subject to one qualification. I have set out below a separate provision for the collection of costs information for review purposes. Professor Fenn has allowed £200 per case for this purpose. After reviewing the evidence and discussion with my assessors of the work which would be involved, I have concluded that the allowance for providing information required for review purposes should be reduced from £200 to £100 per case.

To apply a further deduction to the figures in the Jackson Report for the insurers' contentions on the impact of referral fees is to reject the Jackson Report in that respect and/or to apply a double deduction, ie to add a deduction to that made in the Jackson Report when he specifically confirmed that: …*the arguments advanced on the claimant and defendant side cancel each other out…[page 158 Final Report].*

- **The proposed apportionment between Stages 1 and 2 above and below £10k for both RTA and EL/PL**

The issue is not apportionment. Both rates are far too low for the reasons set out. If anything, the figures themselves and the lack of any objective reasoning to justify them, supports our contention that these are purely arbitrary based on accepting the insurers' contentions and working backwards from there.

A differentiation between stages 1 and 2 can only be justified if an evidence based approach has been adopted. Based on our evidence over thousands of cases, the costs incurred in EL cases are much higher at both stages taken together than is proposed.

The question of apportionment appears to be in issue because some claims drop out after stage 1 in the portal – potentially fraudulent claims where the injury cannot be substantiated for example. We agree that this practice can be stopped by paying stage 1 and 2 costs at stage 2 but if that is the aim and that is the approach adopted there is no point in seeking to differentiate between the costs at each stage.

Differentiation requires an objective evidence based approach which is not the position with these proposals. Certainly EL costs are much higher at stage 1 than the £300 proposed and higher at stage 2 than the £600/£1,300 proposed. But in the absence of the forensic approach we have contended for there is then no point in seeking to differentiate between the costs at each stage. If anything, doing so gives the false impression that the figures properly reflect the work required at each stage.

- **The proposed rate for EL/PL claims at Stage 3**

These are far too low, particularly for cases over £10,000. At this stage there is far greater evidence to present than in cases under £10,000, including witness statements to prepare. The costs should reflect work necessarily done.

Cases below £10,000 also do not appear to have been increased for inflation, in spite of the assurances given when the RTA Protocol was introduced. An appropriate allowance should be made for inflation between 2009 (when the Stage 3 costs were agreed) and 2013 when the

extended regime will commence.

- **The interface between the proposed FRC arrangements within and outside the Protocols, particularly with regard to incentives for either side to exit.**

The interface is not the issue, it is the figures themselves. The proposed table at Annex B is said to be based on Jackson's Table B but amended to take account of inflation since 2009 and reduced throughout by an amount intended to reflect the forthcoming ban on referral fees.

At least here there is some attempt to explain the table, hopelessly inadequate though that explanation is.

No details are given of what component of the adjustment is to take account of inflation since 2009 or what reduction is applied to reflect the forthcoming ban on referral fees.

No explanation of why the detailed case against any reduction to reflect the referral fee ban has been rejected. It appears the insurers' case has simply been accepted without question. Perhaps this is not surprising given the insurers are substantial donors to the Conservative Party and bearing in mind the apparent agreement at the private meeting on 14 February at 10 Downing Street between the Prime Minister and the insurers.

As outlined above in relation to portal costs, Jackson's Table B had already fully taken into account the insurers' contentions on the impact of referral fees. The proposals, therefore, amount to either a rejection of the Jackson Report in that respect and/or application of a double deduction, ie to add this deduction to that made in the report when it was confirmed by Jackson LJ himself that: …*the arguments advanced on the claimant and defendant side cancel each other out…[as above].*

Updated data was recently supplied to Professor Fenn to update these figures but there is no evidence that has been taken into account.

In relation to the interface between the costs within and outside the protocols we endorse the views of Professor Fenn that the new costs mean the defendant's reward for admission of liability would be too high, creating a de facto no-fault scheme. The reductions applied to cases inside the protocol/portal are so extreme that insurers may admit liability on cases which they can legitimately contest.

The solution to this is to properly update the figures in the Jackson Report, using the same evidence based approach as that adopted in 2009 for that report, and including costs in the protocol/portal.

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