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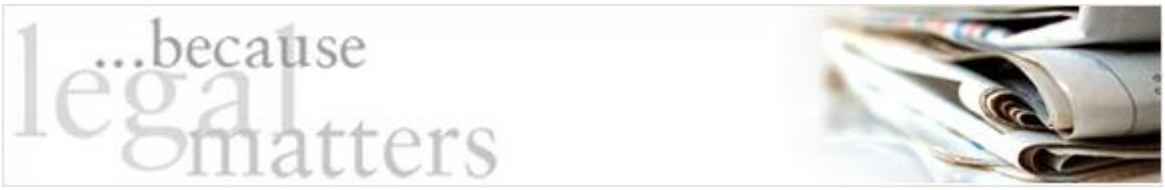


Legal Expenses Insurance: The FSA Demands Freedom of Choice

The FSA's radical shake-up of the legal expenses regime is good news for both the legal profession and clients, as Chris Elwell-Sutton explains.

In a move that is set to have a major impact on the part of insurance industry dealing with legal expenses, the FSA has demanded that by the end of this month, the UK's insurers will need to demonstrate that they are complying with European and domestic regulations giving policyholders the right to choose their own legal representation. The problem facing insurers is that many of their policies give the insured no such right.

Before you decide that an article about the changes in the field of legal expenses insurance is irrelevant to you, it may be good idea to examine the wording of your household insurance policy.

Clients who approach law firms to resolve employment disputes or to engage in civil litigation are frequently pleasantly surprised to discover that buried deep within their household contents policy lurks an unassuming, but potentially extraordinarily useful, clause relating to legal expenses insurance.

Millions of individuals – as well as a significant number of businesses – currently enjoy this protection, many of them without realising it. Indeed, the Ministry of Justice reported in 2007 that 59 percent of the UK population had some form of legal expenses insurance.

What is 'Before The Event' Legal Expenses Insurance?

As opposed to 'After The Event' insurance – a different insurance product beyond the scope of this article – 'Before The Event' Legal Expenses Insurance (BTE LEI) is a traditional form of insurance that allows the insured to use legal services at their insurer's expense upon the occurrence of certain events. Often sold as part of a package along with household insurance, BTE LEI is typically triggered, in a contentious context, at the point at which proceedings are issued.

So you get yourself into a legal dispute, you approach your insurer for funding and all the money you need for your legal expenses appears almost instantaneously in your bank account. Right? Not quite. There are a number of conditions and restrictions that insurers typically apply to the right to claim under BTE LEI, such as an assessment by a barrister that the chances of the insured's case succeeding are 51 percent or greater.

By far the most controversial restriction imposed by insurers, however, is the one that allows the insurer to choose the legal representation the insured is able to use. Rather than allowing the insured to choose their own lawyers, insurers often insist that their policyholders instruct one of an approved 'panel' of solicitors.

So What's the Problem?

For some policyholders, this arrangement works perfectly well. Indeed, for those who are not used to instructing solicitors, having the process taken out of their hands can even be helpful.

However, there are a number of issues with the current system that have contributed to the disquiet that has prompted the FSA's recent actions.

First, the panel system is a very blunt instrument that, in the case of complex, technical legal issues, may well fail to provide the insured with the level of specialist expertise required. Nowhere is this more apparent than in the field of Employment law, an area in which BTE LEI is a common method of funding for claimants. Nick Lakeland, head of Silverman Sherliker's Employment department, comments: "Litigation is much more than just a process. You just can't deal with a complex employment claim the way you can with a traffic accident."

John Abbott, head of Litigation at Silverman Sherliker, shares the view that the panel system is inappropriate for various types of legal dispute: "It's just not a credible notion that a panel solicitor can deal properly with a complex shareholders' dispute or a very technical landlord and tenant issue," he says. "This kind of work requires specialist knowledge and experience – not something you can usually get from a panel solicitor."

There is another, more general, problem with the current system. The panel firms typically pay referral fees to the insurers in return for the regular stream of work being pointed in their direction. Panel firms are also known to incentivise insurers by taking on the work at significantly discounted rates.

This is a radical departure from the traditional business model for the provision of legal services and can easily lead to a situation in which the law firms in question have a much stronger relationship with the insurer than with the insured. Furthermore, they have little incentive to offer the insured a high level of service, since it is the insurance company – and not their client – to who they will look for further instructions.

It's not difficult to imagine how this system fails to deliver the best service for clients and horror stories are not uncommon. Indeed, Nick Lakeland believes that this system creates "factory firms who run thousands of files and who do not, and cannot, look after their clients properly in the way a firm like ours does".

Are Insurers Breaking the Law?

The short answer is … probably. British insurers providing BTE LEI are obliged to abide by the Insurance Companies (Legal Expenses Insurance) Regulations 1990 (the Regulations). These Regulations give domestic effect to a European law: Council Directive 87/344/EEC on Legal Expenses Insurance (the Directive).

One of the main principles of the Directive and the Regulations is that the insured has a right to choose his or her own legal representation. The latest version of a letter by Ken Hogg, head of the FSA's Insurance Sector confirms what many had believed for some time – that insurers were acting unlawfully by restricting the insured's choice of lawyer in their BTE LEI.

As Mr Hogg's letter acknowledges, there are exceptions and situations in which this right does not exist and an exact, definitive statement of English law will only be forthcoming when a judge decides a test case on this issue. However, Mr Hogg's letter to all British insurers hammers home the FSA's position.

There can now be little doubt that the European Court of Justice's judgment in the *Eschig* case – confirmation that insurers should not restrict the insured's choice of lawyer – should be followed in the UK. Furthermore, the FSA has put the onus firmly on the insurance industry to demonstrate its compliance.

What Happens Next?

The ultimate effect of this clarification of the law is not entirely clear. James Pretsell of Farrar's Building Chambers is a barrister who has worked on numerous high-profile employment cases and has been instructed by Silverman Sherliker many times on behalf of the firm's clients.

He believes that one major change insurers will have to bring about in response to the FSA's guidance relates to the speed with which the insurer has to deal with a request from the insured to choose a non-panel lawyer. "The employment tribunal time limits are amongst the swiftest and most stringent a lawyer has to deal with," says Mr Pretsell. "An insurer will therefore have to be swift to deal with an insured's request for his or her own lawyer in order to ensure that the insured really does have a choice."

He goes on to explain the likely legal status of terms that purport to restrict the insured's choice of lawyer. There is no need for concern, he contends, about the prospect of non-compliant insurance policies suddenly becoming void. "These constitute unfair terms in consumer contracts. Such terms do not bind the insured," he explains. "However, the contract continues to bind the parties provided it can continue without the unfair term, as is required by Regulation 8 of the Unfair Terms in Consumer Contracts Regulations 1999.

"It seems to me that the insured can instruct his own lawyer and the insurer will almost certainly have to indemnify him for the lawyer's costs, albeit that the insurer will likely be able to set the recoverable level of those costs." Should an insured person believe that an insurer is in breach of the Regulations, he explains,

he or she can seek redress from The Office of Fair Trading or from the FSA itself, both of whom have various sanctions available to them.

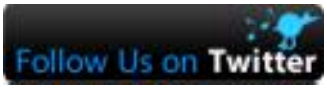
One concern is that by demanding what will be, for insurers, a more expensive and onerous service to provide, the FSA may be pushing the insurance industry into doing away with BTE LEI altogether, or at least into making it far more expensive.

It may well be the case that the current business model – in which tens of thousands of pounds' worth of legal services can somehow be offered in return for a negligible supplement to an insured's household insurance premium – is only viable for insurers because of the referral fees and discounts their panel firms give them. Take that away and the system may ultimately collapse, denying many policyholders access to any legal services at all.

But perhaps a system that is so deeply flawed – both in terms of compliance with the law and, arguably more importantly, in terms of the service being offered to clients – must either radically adapt or be allowed to fail. For the moment, the good news is that holders of legal expenses insurance can look forward to genuine freedom of choice and the better standard of care that goes with it.

If you have legal expenses insurance and may be engaging in an employment dispute or other litigation, our Employment or Litigation teams can help.

Contact Nicholas Lakeland, Senior Employment Partner (**ncjl@silvermansherliker.co.uk**) or John Abbott, Senior Litigation partner (**jca@silvermansherliker.co.uk**) on +44 (0)20 7749 2700.



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