

## Lawyers and Referrer Conflict—an underrated risk

The risk of a conflict of interest can arise in some arrangements where lawyers have a relationship with a party from which they receive regular client referrals. The extent of this conflict of interest and associated risks and potential harm, have not, to date, been fully appreciated by the profession, the ethics literature or regulators.

This article discusses how various formal, and informal, arrangements can compromise a solicitor's fiduciary duty to his or her client—and in some cases can cause significant client detriment. Rather than 'one-off' cases, these arrangements can be a core part of the lawyer's business model.

We briefly outline a number of examples of "referrer conflict" and provide more detail of one particular area—that of car accident recovery—to further illustrate the problem and show why an urgent regulatory response is required.

### "Referrer Conflict"

Community legal centres WEstJustice and Consumer Action Law Centre have seen many clients who have suffered as a result of a transaction where they obtained 'independent' legal advice or representation from a lawyer who regularly received referrals from a party with an interest in the matter.

This type of problem was recently highlighted by a senate committee report on the Scrutiny of Financial Advice. The committee highlighted losses suffered by investors as a result of land-banking investments that were promoted by spruikers. The Committee noted:

"a common thread running through the land banking schemes investigated by the committee was that the promoters of the schemes referred investors to lawyers, accountants and lenders with whom they had a potential conflict of interest because of their pre-existing (and often intertwined) business relationships."<sup>1</sup>

In another example, when Money for Living (MFL) collapsed in 2005, many older people lost their homes and an incorporated legal practice was found guilty of misconduct.<sup>2</sup>

The firm took referrals from MFL (which was located in the same building) to represent consumers who were entering into agreements with MFL. The law firm prepared a range of documents, including property sales documents to conform with MFL's scheme.

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<sup>1</sup> Senate Economics References Committee, Parliament of Australia, Scrutiny of Financial Advice Part 1 Land banking: a ticking time bomb (2016) [5.21].

<sup>2</sup> Legal Services Commissioner v Diakou (Legal Practice) [2010] VCAT 2138 (17 August 2010).

Judge Misso found that the lawyer’s “failure to recognise that there was a conflict of interest had the most grave consequences for the victims of the scheme”. However, he accepted that “the lure of a client bringing in work ...blinded [the lawyer’s] judgment”. He accepted that the lawyer believed that “he was acting for the victims of the scheme” and “was blissfully unaware there was a conflict of interest...”.

In a recent case,<sup>3</sup> a legal practice received most, if not all, of its work, from a firm that provided replacement vehicles to ‘not-at-fault’ drivers while their car was repaired after an accident. Legal proceedings were issued in the name of the ‘not-at-fault’ driver to recover loss from an ‘at fault’ driver. The senior VCAT member noted that the law firm’s conduct indicated that the law firm’s actual client was the car hire firm.

The lawyer director was prosecuted for acting on behalf of a person without obtaining any instructions.

While disciplinary action has been taken in these cases, this often only follows where there is evidence of severe misconduct and client detriment.

#### Car accidents, repairers and replacement vehicle hire.

Consumer Action Law Centre and WestJustice have previously raised concerns about the relationship between repairers, replacement car-hire firms, recovery agents and lawyers in the media and in formal submissions.<sup>4</sup>

Measures taken by car insurers to control repair costs have placed pressure on the car repair industry.<sup>5</sup> In order to maintain profits of car repairers (and some argue to give consumers better quality and freedom of choice of repairer) complex schemes have been developed. These schemes involve the repairer and recovery agent and/or lawyer recovering damages from the party that caused the accident. However, recovery action is usually taken in the name of the consumer who may have little to gain and have little understanding of the risks.

This is big business. One indication of the size is an estimate by insurer Suncorp Group that “the costs associated with third party repair networks is adding approximately \$33 a year to the cost of insurance premiums in Victoria”.<sup>6</sup>

Here we examine the role of lawyers and the risks faced by the consumers who become the clients.

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<sup>3</sup> Victorian Legal Services Commissioner v Logan (Legal Practice) [2016] VCAT 544 (8 April 2016).

<sup>4</sup> Consumer Action Law Centre and WestJustice, Submission to the Essential Services Commission (Victoria), *Accident Towing and Storage Economic Regulation Review*, October 2015. <http://www.esc.vic.gov.au/getattachment/d5e2e791-c6ee-4897-aba3-67adae0ec8b4/Consumer-Action-Law-Centre.pdf>

<sup>5</sup> David Purchase, ‘Enough is Enough – It’s time the unconscionable conduct of some insurance companies towards their crash repair associates stopped’, *Australian Automotive*, June 2014

<sup>6</sup> Suncorp Group Ltd, Submission to the Essential Services Commission (Victoria), *Accident Towing and Storage Economic Regulation Review*, October 2015, 2.

## The authority form

A typical arrangement may be as follows:

An individual has a car accident. Either the customer chooses a particular repairer or a repairer is suggested by the tow truck operator (who may have a relationship with the repairer). The customer signs an authority provided by the repairer or car-hire firm. The authority is to repair the vehicle, although there is usually no quote at this stage. The same form may also authorise the repairer to:

- Arrange a qualified assessor to determine the cost of repairs;
- Recover the costs of repairs (as assessed), and other losses (for example for replacement car hire);
- Instruct lawyers on the customer's behalf;
- Deal directly with the at fault third party (and any insurer or representative);
- Sign any document on the customer's behalf, including a settlement of the claim;
- Commence and conduct legal proceedings in the customer's name; and
- Apply any amounts recovered first to the costs of repair and secondly to any legal costs.

The agreement may also make the customer liable for all costs to date (repair and legal) if they try to cancel the agreement.

## Marketing

Repairers and replacement car rental providers promote their services to customers on the basis that they may protect their 'no-claim-bonus', or recover car rental costs that they couldn't claim from their own insurer. Customers are generally advised not to contact their own insurer, but to allow the car repairer to liaise with the insurer.

## Outcomes

In the cases we have seen, the consumers have had no understanding that they may be involved in legal proceedings—let alone an understanding of the risks.

If recovery from the third party is unsuccessful, the customer may:

- Be liable for legal costs to the third party;
- Have breached the terms of his or her insurance policy by not informing the insurer about the accident; and
- Face a very high repair bill and/or hire-car bill and may be unable to recover the car from the repairer until the bill is paid (for this reason these schemes are often referred to as 'car-napping').

Other poor outcomes can include that:

- The customer may be involved in a court case without having any understanding that this may occur;

- The customer may be unable to find out what money has been received by the repairer and how it has been disbursed;
- Damages received from the third party for a write-off will be based on market value, whereas the consumer may have received more by claiming from their insurer if they had an 'agreed value' policy; and
- The amount recovered from the third party may be less than the consumer's liability – particularly in relation to hire-car fees.

#### Relationships between repairers, hire car firms and lawyers

In some cases, the relationship between the lawyers and the other firms involved is simply one of regular referrals. However, if the referrals are a significant source of income for the lawyer, the lawyer may have a conflict that has an impact on clients.

Sometimes the relationship is a lot closer than this. The lawyer may have drafted the authority which authorises the repairer to instruct the lawyer and which was drafted with the interests of the repairer (and possibly the lawyer) in mind.

The lawyer may also have a formal relationship where they and the repairer are both directors of the law practice or of a related debt recovery firm. The law firm may be co-located with the repairer or car hire firm.

Some lawyers are clear about their role in increasing profits for repairers. One lawyer explained that the authorities are worded so that the repairer receives the payment directly so that the repairer is "rewarded by their undertaking the repair job at the end of the day". He also stated that repairers are "worried that the innocent party will collect the funds", and either will not repair the vehicle or try to negotiate a lower price with the repairer.<sup>7</sup> Another law firm promotes itself as "auto industry profit consultants".

#### Benefits to the consumer?

Where a consumer has no insurance, the consumer may benefit from pursuing the third party for damages if they are not at fault. However, it is important that the risks are fully explained before the consumer commits to this course of action.

Even when a consumer isn't comprehensively insured, third party property insurance now carries 'uninsured motorist extension' which will pay up to \$4,000 for repairs if the insured is not at fault and the damage is caused by an uninsured driver.

For consumers who have comprehensive insurance, it may be simpler, and lower risk, to lodge a claim. However, they are generally discouraged from doing so by the repairer. If recovery action isn't successful it will usually be too late to lodge a claim.

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<sup>7</sup>James Wood on behalf of Ecollect.com.au and EC Legal, Submission to the Legislative Assembly of NSW, *Select Committee on the Motor Vehicle Repair Industry*, Jan 2014, 2

Even if a consumer wants to engage a lawyer, they should have the opportunity to engage a lawyer who is less likely to be focused on the profitability of the repairer.

Is the problem addressed if the lawyer obtains clear instructions?

The Victorian Legal Services Commissioner has notified the profession<sup>8</sup> that they must obtain clear instructions from the client, and that “It is unacceptable that a client is given no explanation or advice prior to signing a form and assigning their rights.”

However, in these repairer cases, the consumer has usually signed an authority which binds him or her to proceeding as required by the repairer. Even clear advice about legal rights and risks after the authority is signed does not address this problem. At the very least the lawyer would need to be prepared to take action against the car repairer. This is most unlikely given the relationships—particularly as it is often the lawyer who has drafted the unfair authority in the first place!

A further problem will arise if the consumer then wishes to seek independent legal advice about this type of arrangement. The consumer may be locked into litigation already issued by the nominated lawyer and a contract with the repairer or recovery agent that will state that withdrawing from the litigation or withdrawing instructions from the nominated lawyer will constitute a breach of the contract. To cap it off, upon seeking independent advice, the consumer may be told that as they have a lawyer on the record it is not ethical for another lawyer to give advice about the case.

## Taxi Clubs

A range of very similar problems have arisen in relation to taxi accident repair. Until recently, in Victoria, there was no obligation for taxis to be insured by an APRA approved insurer. Taxi Clubs, which are incorporated associations, provided some protection to taxi owners through an indemnity but payment was at the discretion of the taxi club.

A number of lawyers acting for the taxi clubs acted on behalf of taxi drivers under the (mistaken) belief that the taxi clubs had a right of subrogation (the right of an insurer to legally pursue a third party that caused an insurance loss to the insured).

WEstJustice had a number of taxi driver clients who had legal action issued on their behalf, by a lawyer, without their knowledge. When the case was lost, the taxi clubs sometimes chose not to indemnify the driver. In many cases the drivers faced bankruptcy as a result, and two clients faced the possibility of losing their family home.

One additional conflict that arose in these cases was that the lawyers had acted in a number of similar matters, and were aware that one or more taxi clubs had, in past cases, refused to indemnify the driver without reasonable cause. Not only should it have been clear to these

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<sup>8</sup>Legal Services Commissioner (Vic), Acting in Vehicle Accident Claims (Fact Sheet), October 2015  
[http://www.lsbcc.vic.gov.au/documents/Fact\\_sheet-Acting\\_in\\_motor\\_vehicle\\_accident\\_claims-2015.pdf](http://www.lsbcc.vic.gov.au/documents/Fact_sheet-Acting_in_motor_vehicle_accident_claims-2015.pdf)

lawyers that they were acting for a driver without any instructions or other basis for doing so, but they were aware that if the case was lost the taxi club may refuse to pay.

### Are these problems reflected in complaints to regulators?

The Victorian Legal Services Commissioner has stated that his office “regularly receives complaints about lawyers who act in motor vehicle accident matters”, where consumers have signed documents they don’t understand and lawyers have issued proceedings in the complainant’s name without instructions.<sup>9</sup>

However, we believe the complaints lodged represent a very small proportion of those experiencing these problems. Both our services have acted for many clients who are not interested in lodging a complaint against a lawyer once they have resolved their problem.

The main reasons for this appear to be:

- These consumers often believe that their main dispute is with the third party or the repairer. They don’t consider the lawyer as the main cause of their problem and don’t believe that complaining about the lawyer will resolve their situation
- In many cases the consumer wins, or the matter is settled in the consumer’s favour. While the lawyer may have acted without adequate (or any) instructions, there is no incentive for the consumer to report that to the regulator

There is a need for legal regulators to use other means to identify unethical and high risk practices other than relying on receiving complaints.

### WestJustice and the insurance industry.

WestJustice has helped more consumers trapped in ‘car-napping’ cases than any other community legal centre. The service is currently in discussions with the insurance industry which may provide a grant to the centre to enable us to help more of these consumers.

So is there a risk of a conflict of interest in WestJustice accepting funds from the Insurance Council of Australia and acting in cases where the Council’s members may have an interest in the outcome? As in any situation where a referrer or funder has an interest in case outcomes, there is a potential risk which the centre must manage. WestJustice will be transparent about the source of funding it receives (for example in our annual report) and will stipulate in any funding agreement that no insurance company or the Council will influence the way we act for our clients. In providing the funding, the Insurance Council is aware that WEstJustice has expertise in running cases against insurance companies and that it will continue to do so.

WestJustice CEO, Denis Nelthorpe, took on many insurance disputes for consumers as part of Victoria’s “Bush Fire Legal Help” program, and the service will continue to run cases against insurers where that is in the best interest of the client.

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<sup>9</sup> Ibid

## A growing problem?

As insurance companies squeeze the profits of car repairers, a business opportunity has opened up for lawyers to help repairers increase their profits but the system cannot work without the involvement of the customer/client. Unfortunately, too many clients don't know what they have agreed to until it's too late.

A growing number of law graduates are experiencing difficulty in obtaining employment. This may lead to the creation of different business models or referral channels that help to build a legal practice and create legal jobs. Indeed, some of the practitioners who have faced regulatory action have been very new to the profession.

## Addressing referral conflict

Some lawyers in the community sector, including the authors, are somewhat cynical about the approach of the profession, academics and conduct rules, when it comes to ethics. Duties such as confidentiality and avoiding conflict between clients are of course essential, but the focus of discourse is often very theoretical, and is more applicable to issues that arise at the "big end of town".

Yet we are seeing conduct, and business models, which are increasingly placing clients and the general public at risk,<sup>10</sup> in a way that the current legislation and professional rules may be ill-designed to address.

These problems tend to generate a low level of complaints, so new ways to identify the risks and harms must be considered, which may require amendment of the powers of the regulator.

Action is required to prevent harm before it occurs—to the general public, clients and to the reputation of the profession.

Gerard Brody and Denis Nelthorpe are Victorian lawyers with many years experience in the community legal services sector. Gerard is CEO of Consumer Action Law Centre. Denis is CEO of WEstJustice.

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<sup>10</sup> The role of lawyers in some debt collection businesses raises similar issues where main harm was to members of the public (rather than clients) see *Legal Services Commissioner v Sampson*