

SUBMISSION TO THE PRODUCTIVITY COMMISSION BY LEGALWISE AUSTRALIA PTY LTD

To the extent that it may be relevant to assist the Commission in its task, we refer to the general comments in our initial submission, which was provided after the deadline for submissions had passed and may not have been taken into account for the Draft Report recently published. In this submission, we will restrict ourselves to the Information Requests by the Commission that are of relevance to legal expenses insurance (LEI), or alternative structures to achieve the same outcome.

We have extensive experience (30 years), in the LEI market and if the Commission requires additional information or clarification about any related matter, we will gladly oblige. Through our membership of RIAD (see below), we have access to information about LEI worldwide. That includes information about the public policy issues that has resulted in this class of insurance being treated worldwide as a specialist vocation with unique challenges.

Information request 19.1 (The Commission seeks feedback on the prospects of LEI being offered by private providers and whether there are any public policy impediments to such an offering).

THE PROSPECTS OF LEGAL EXPENSES INSURANCE BEING OFFERED BY THE PRIVATE SECTOR

1. This submission is made by the wholly owned subsidiary of an Australian owned specialist legal expenses insurance company registered in South Africa, doing business exclusively in Africa (more information is available at <http://www.legalwise.co.za>). The company too, tried unsuccessfully to promote legal expenses insurance in Australia two years ago. Consumer interest was low and the uptake too slow to justify the massive investment that would be required over an extended period of time to create sufficient numbers to achieve the essential spreading of the insurance risk.
2. To our knowledge, Australia and New Zealand are the only English speaking countries that do not have a viable legal expenses insurance sector. It has been a successful specialist class of insurance in France and Germany for nearly a century. For varying lengths of time it has been common throughout countries in Continental Europe, including the former “Eastern Block” countries. The question that naturally arises, is what the relevant differences are between Australia and those countries where it is a common class of insurance. We attempt to answer that question below.

- a. Legal system structure and regulatory aspects

Between all the countries where LEI is successful, there are significant differences in the structures and regulatory aspects of the legal system. Any difference in the Australian legal system can therefore be safely discounted as a potential cause for the failure of LEI in Australia. It is our view that the cause is a major difference in consumer culture, which we refer to in b (v) below.

- b. International history of the triggers for consumer demand

- i. Around 1917, an event that aroused mass public interest occurred. There was a catastrophic accident at the famous Le Mans motorcar race, as a result of which a many spectators died or were seriously injured. When the victims claimed damages against the insurers, their claims were repudiated. At their wits' end, they joined forces and started a campaign to raise funds from well-wishers to enable them to sue the insurers. They succeeded and the penny dropped. The first legal expenses insurance scheme was born in France and it was called "Rencontres Internationales des Assureurs Defense" (insurance against the insurers).
- ii. Not too long after Le Mans, another motor car race-related activity became an issue in Germany. Private clubs like say, a Porsche club, would organise Sunday excursions that involved races on public "autobahns". Accidents and prosecutions became common. Members of the various clubs formed pools out of which to pay the legal expenses of any member prosecuted or sued. Again the penny dropped. This time however, it was the equivalent of the RAC that designed a product and offered it to the general public. That institution was called Deutsche Automobile Sportiff (DAS) which eventually became a specialist legal expenses insurer. Today, the DAS is still the worldwide leader in legal expenses insurance.
- iii. After France and Germany, motoring clubs like RAC, followed suit. For a long time the insurance cover was restricted to serious road traffic issues. Over the decades that followed, cover was gradually expanded to cover the entire spectrum of individuals' lives, and ultimately, small to medium sized enterprises. In some countries, notably the UK, LEI cover for motoring related legal problems is still a major component of total LEI business.
- iv. By contrast to the history of LEI in Europe, the situation in South Africa presents an interesting parallel. There was also a major event preceding the introduction of LEI in 1984. The event was of even greater significance than one motor car race gone wrong. It was the policy of "apartheid" that lasted for many decades and affected the lives of 80% of the population, who was marginalised in terms of access to the legal system as consumers and as potential legal professionals. It is that event, we believe, that moulded public perceptions of the great need for affordable access to the legal profession. The perception of the need was so strong that it resulted in the fastest growing LEI venture in the international history of the class.
- v. The apparent lesson to be learnt from international experience, is that the success of LEI hinges on one thing: a perception of the need by the consumers of legal services. That perception is absent in Australia, and in our view, is due to mainly 4 factors: (1) the very stringent regulation of the private sector, which reduces the risk of consumer "abuse" (2) the existence of an extensive ombud network that further reduces consumer abuse (3) the

existence of a comprehensive network of organisations providing free legal services (4) a perception by the public that the State will look after their legal needs.

Our view is that Australia is unique with respect to these 4 factors and it is that uniqueness that accounts for the absence of a perceived need for LEI and hence, the failure of LEI in Australia. Rather than it being interpreted as an indictment, it may speak volumes about a possible Utopia in which LEI may not be needed.

- vi. The situation in the USA is unique and we will not deal with it here, except to say that legal expenses insurance as per the European model is largely absent and is replaced by a variety of schemes that are a hodgepodge of “cafeteria plans”, “prepaid legal services plans” offered by affinity groups like Universities to their students, “multi-level” marketing schemes, trade union sponsorship etc. The American situation may be of interest to similar groupings in Australia, but it has no bearing on LEI as a purist specialist vocation.
3. However, given the above factors, if it is inevitable that there are currently, and there will in the future be increasing fiscal policy constraints that militate against maintenance of the status quo in Australia, a major effort will be required to create an event of sufficient magnitude, to change a public mindset which has been inculcated for generations. Without a major intervention (and given the public policy complications that require speciality and independence), we express our reservations about whether LEI would elicit the interest of the private insurance industry. As part of a major intervention, the State may have to:
- a. severely clamp down on the funding of legal aid and other State sponsored initiatives, as they did in the UK (which for a long time had the most comprehensive legal aid system in the world);
 - b. educate the public on a new way of personal planning and self-sufficiency;
 - c. consider an active role in promoting a viable LEI sector. A joint initiative between the State and the private sector might succeed. If the GIO venture in 1987 did not succeed, it may have been due to communication and marketing strategies. A commentator from the Flinders Institute remarked that marketing has been the main cause of the failure of LEI in Australia. This leads one to the trite comment that no matter how technically sound the marketing effort might be, if the perception of a need is absent, the first step is to create an awareness of the need, which will be a mountain to climb. In addition, to achieve a desirable level of independence (see below), awareness of the need must be significant enough to enable promotion direct to end users.

4. Other significant incentives exist to promote a viable legal expenses insurance sector.
 - a. Most of the possible reasons for cost inefficiencies in the legal profession are typically addressed in the unique tri-partite relationship that is created between the paying party (insurer), the lawyer and the client. The insurer has a vested interest in ensuring cost efficiency, speed and desirable outcomes. The client has a knowledgeable ally that can interface with the lawyer. If managed properly, there are three clear winners: the lawyer, client and insurer. A fourth winner by default is the State. A vibrant legal expenses insurance industry reduces pressure on public coffers to fund initiatives like Legal Aid which may be open to abuse.
 - b. Even in the current environment of extensive ombud and free legal services, there exists a significant unmet need, which can be termed as “mundane” in the eyes of a lawyer, but which may be of significant importance to a consumer. It may surprise many that the unmet need is not for legal advice. When parties are in conflict, they have no desire to talk to each other. Legal advice to a layman does not resolve this problem. In many if not most such situations, a person needs a lawyer (often immediately), to address or intervene in some or other way with the other party on his/her behalf.

In Australia, it is well nigh impossible to phone and be put through to a lawyer straight away. The potential client would first have to explain what the problem involves, and may then be connected. Invariably, after a very brief discussion, which will involve a discussion about a costs agreement to be signed, prior to any work being performed, a consultation would be arranged. Only a consumer with a grave problem, or much to be gained financially, will sign the costs agreement and turn up for the consultation. The public perception of lawyers and their charges is a negative one and many people would not bother, thereby potentially worsening their problems. That is the unmet need. An LEI insurer has a vested interest in ensuring that small legal problems don't become big (insured) legal problems, because it is then faced with having to pay higher legal expenses. Their focus is therefore on encouraging the usage by insured persons of in-house intervention/mediation services aimed at user friendly, fast and effective solutions.

PUBLIC POLICY IMPEDIMENTS

Four issues are relevant: conflict of interest, independence, privileged communication and usage/free cover.

As a result of the first two issues, LEI products are ideally sold as “stand alone” insurance policies, by specialist insurers, i.e., they offer no other short term insurance products.

In the UK and Continental Europe, the industry operates independently of the general insurance industry and is represented by its own Association called the International Association of Legal

Protection Insurance (RIAD), based in Brussels (more information is available at <http://www.riad-online.eu/12.0.html>).

1. **Conflict of Interest**

Potential conflict is particularly pronounced if LEI is a component of another insurance product; say a motor vehicle or home insurance contract (the main product). It arises when the insured makes a claim on the main product and the insurer rejects the claim for any reason. The question that arises then is whether that insurer will “allow” the insured to use the LEI component to sue itself. Many insurers will no doubt be aware of the potential conflict and then exclude from the LEI component, legal action against itself. That resolves the insurer’s problem, but it leaves the insured with no legal protection against his/her main product insurer. If the insurer as a matter of good public policy does not exclude action against itself, the potential conflict remains intact because it is still the insurer that must then make a decision whether it will “allow” litigation against itself to proceed. If the rejected claim on the main product has a high value, the temptation to look for reasons to reject the LEI claim as well, could be strong.

The same potential conflict exists if the provider of any other service (be it financial services or general consumer goods), offers an LEI product to its customers.

We recommend that the European model of requiring insurers to be specialist LEI providers, or at least requiring a multi-line insurer to establish an independent LEI claims handling unit, be followed. An appropriate amendment to the Insurance Contracts Act to prohibit a provision in the policy that excludes cover against such a multi-line insurer would have to be considered.

2. **Independence**

An LEI insurer has an obligation, similar to that of a lawyer, to ensure that the rights of insured persons are pursued without fear or favour, whoever the transgressor of those rights may be. If, for example, the insurer has business ties with the transgressor of an insured’s legal rights, it may have a negative influence on how the claim for payment of legal expenses to pursue litigation, is handled by that insurer. If for example, a bank, retailer or insurance broker (intermediary), is the main source of an insurer’s business and the intermediary transgresses the insured’s legal rights, will the claim against a main business supplier be pursued with the appropriate vigour? The result is likely to be the same as in 1. Above.

Independence can only be achieved, if the LEI insurer promotes its products direct to end users. For that to be successful, a significant level of perception of the need has to be created first.

3. **Privileged Communications**

When a client consults with a registered lawyer, that communication is privileged and the lawyer cannot be forced to divulge the information. If LEI were to be established in Australia, appropriate legislation to afford the same status to communications between the insured and LEI insurer, will have to be considered.

4. Usage of Intervention Services versus Legal Advice

- a. A potential pitfall for consumers currently, is the mushrooming of “free” legal advice services on the internet and via other channels. A free service is good if it is truly free. If a car dealer has an advertised price for a car that is the same as other car dealers, but throws in a free 1 year service contract, it is free. However, if a lawyer says the 1st half hour consultation is “free”, then, if there is no fixed price for subsequent work and the lawyer can recover his/her fees for that half hour, by “working it into” subsequent charges, it is open to abuse. If LEI is widely available, this potential pitfall is avoided, since the cost of intervention and mediation is already accounted for in the insurance premium which is fixed.
- b. Another potentially problematic area, is the provision of “free” or cheap telephonic or internet based legal advice services by an assortment of institutions, with the primary aim of offering their existing customers a benefit with high perceived value, at a very low cost. Since low cost is the driver of such initiatives, usage and consequent benefit to the consumer is severely compromised. Attractive as it may sound at first, in most cases a consumer will only realise that s/he still has to consult with a lawyer, after receiving the “free” or cheap advice. As a matter of public policy, we have no views on how this can be regulated. If however, LEI with mediation and intervention services becomes widely available and accepted, market forces will regulate the situation as consumers will eventually realize the need for extensive intervention and mediation services.

Information request 19.3 (The Commission seeks feedback on whether there are any policy barriers that unnecessarily obstruct not-for-profit provision of legal services).

In our view, scope exists to offer an LEI “look alike”, through the vehicle of a non-profit Co-operative, of which the founding members can be the respective Law Societies, or even the State. The Co-operative can then employ an LEI expert to manage the membership rules (identical to an LEI policy), at a fixed rate. The barrier to this is not the existing regulatory framework or official policy, but rather unofficial resistance and consumer scepticism. The latter can be overcome with the participation of these institutions.

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