Just in case

Alison Padfield examines legal developments in before the event legal expenses insurance

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Legal expenses insurance remains an area of intense interest and concern for the profession, particularly in the current economic climate when individuals and companies must consider all other avenues before resorting to litigation. The principal forms of insurance are:

- insurance against an adverse costs order bought by claimants whose lawyers are acting under a conditional fee agreement (commonly known as 'after the event' (ATE) legal expenses insurance);
- insurance bought before the insured event has taken place ('before the event' (BTE) legal expenses insurance), which may combine cover for the insured's own legal costs and against any adverse costs order; and
- insurance against the insured's own costs, and often also against an adverse costs order, provided within a policy of liability insurance such as professional indemnity insurance.

This article is concerned with BTE legal expenses insurance cover.

Legal framework

BTE legal expenses insurance cover is regulated in England and Wales by the Insurance Companies (Legal Expenses Insurance) Regulations 1990 (SI 1159/1990, as amended) (the LEI Regulations). The LEI Regulations implement Directive 87/344/EEC of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance (the LEI Directive). Legal expenses insurance cover provided within a policy of liability insurance is outside the scope of the LEI Regulations.

Insurance companies that issue policies of legal expenses insurance are regulated in England and Wales by the Financial Services Authority, and complaints by consumers about the way such policies are sold or how claims are handled may be made to the Financial Ombudsman Service.

Freedom to choose a lawyer

The LEI Regulations provide that, subject to a limited exception in relation to motor vehicle cover (reg 7), an insured is entitled to choose his or her own legal representative 'to defend, represent or serve the interests of the insured in any inquiry or proceedings' (reg 6(1)), and also 'whenever a conflict of interests arises' (reg 6(2)), and that these rights 'shall be expressly recognised in the policy' (reg 6(3)).

Reg 6 applies only if the legal expenses insurer has take the steps prescribed in reg 5(2) and (3) to ensure that legal expenses insurance claims are handled separately from claims in relation to another class of general insurance business; if it has not, the insured must be given the right in the policy to choose a lawyer 'from the moment he has the right to claim from the insurer under the policy' (reg 5(4)). This article considers the former situation, which is how legal expenses insurers normally operate in England and Wales.

In *Erhard Eschig v UNIQA Sachversicherung AG* [2009], the European Court of Justice considered the Austrian legislation implementing the LEI Directive and, in particular, the freedom to choose a lawyer. The case concerned a clause in a policy that restricted the insured's right to choose a lawyer where losses were suffered by a large number of insureds as a result of the same event (a so-called 'mass tort'). The court held that the LEI Directive did not permit the legal expenses insurer to reserve the right to select a legal representative for all of the insureds in this situation. In its reasoning, the court said, at paras 46 and 52:

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> ... it follows from the wording of Articles 3, 4 and 5 of [the LEI Directive] and from the context of that directive that the right to freely choose a representative is granted to every insured person in a general and independent way, within the limits set by each of those articles.

In addition, the 11th recital in the preamble to [the LEI Directive] confirms that the right to freely choose a representative in the context of an inquiry or proceedings is not connected to the occurrence of a conflict of interests.

The decision in *Eschig* has been widely interpreted as an indication that the European Court of Justice will interpret the LEI Directive as not permitting any restriction on the freedom to choose a lawyer other than those limited restrictions expressly set out in the Directive itself.

When does the right arise?

In England and Wales, this has led to increased attention being focused on the stage at which the freedom to choose a lawyer arises and, in particular, on the meaning of 'any inquiry or proceedings' in reg 6(1) of the LEI Regulations.

The LEI Regulations pre-date the Woolf reforms and the Civil Procedure Rules and, in particular the Pre-Action Protocols. Clearly, in 1990, 'proceedings' would have been interpreted as meaning the issue of legal proceedings, and not the sending of any letter before action. Under the Civil Procedure Rules, however, the letter of claim is a significant step in the pre-action procedure, and may significantly influence the course of the proceedings. This is reflected, for example, in para B2.3 of the Professional Negligence Pre-Action Protocol, which provides:

> The Letter of Claim is not intended to have the same formal status as a Statement of Case. If, however, the Letter of Claim differs materially from the Statement of Case in subsequent proceedings, the Court may decide, in its discretion, to impose sanctions.

Financial Services Authority

However, the position taken by the Financial Services Authority is that the freedom to choose a lawyer does not arise until after the protocol procedure has been concluded. In its letter to BTE legal expenses insurers in July 2010 (revised in August 2010), written with reference to the Eschig decision, Ken Hogg, director of the Insurance Sector, said:

> Under [the LEI Regulations], the freedom to choose a lawyer arises in the following areas:
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> 1. Principally under Regulation 6, where recourse is had to a lawyer to represent the insured in any inquiry or proceedings. It is important to note that freedom of choice arises *before* the commencement of any inquiry or proceedings. [Emphasis added]

A footnote to this passage is as follows:

> This freedom has been interpreted as being triggered at the time when efforts to settle a claim by negotiation have failed and legal proceedings have to be initiated (see Sawar v Alam [2001] EWCA Civ 1401 at paragraph 26). Once it becomes clear that recourse is to be had to legal proceedings and litigation is pending then the insured may instruct a lawyer of their choice. This is because, generally, recourse to a lawyer logically precedes the commencement of legal proceedings which the lawyer initiates on behalf of his client.

Once the right to choose a lawyer has arisen, is the BTE legal expenses insurer entitled to impose terms on the lawyer's appointment?

The letter therefore appears to suggest that the right arises before the claim form and particulars of claim are drafted, but after the protocol procedure has been concluded. This reflects the long-standing position of the Financial Ombudsman Service. This was referred to without comment at para 26 of the judgment of Lord Phillips MR (giving the judgment of the court) in *Sarwar v Alam* [2001]. Consequently, *Sarwar* does not, in itself, provide authority for the position taken by the Financial Services Authority or the Financial Ombudsman Service.

The issue remains highly contentious: see, for example, a letter from DAS Legal Expenses Insurance Company Ltd dated 3 September 2010 to a solicitor representing an insured, which states that DAS 'fundamentally disagrees' with the Financial Services Authority's interpretation of the *Eschig* decision, and which is annexed to the Response by the Association of Personal Injury Lawyers dated 12 October 2010 to the Review following *Eschig* (Legal Expenses Insurance by the European Commission) (see Appendix 5 to the APIL Response).

Financial Ombudsman Service

The position of the Financial Ombudsman Service was set out in the March 2003 edition of Ombudsman News as follows:

> First, we considered arguments that the policyholder's 'freedom of choice of solicitor' (as provided for, at the point when proceedings commence, in the [LEI Regulations] should be interpreted more widely than is traditionally the case. Should it perhaps include any significant legal enquiry (for example at the time when the claimant's solicitors embark on the 'pre-action protocol')?

We concluded that, in the absence of clear guidance from the courts in support of this alternative interpretation, we would not require an insurer to offer the policyholder a choice of solicitor at the start of the claim.

The Jackson Review of Civil Litigation Costs

The difficulties inherent in this approach were described by Lord Justice Jackson in his 'Review of Civil Litigation Costs: Final Report' (para 1.3 of Chapter 8) as follows:

> Regulation 6 of the LEI Regulations is interpreted both by BTE insurers and the Financial Ombudsman Service as meaning that the insured has a right to choose his or her lawyer at the moment when proceedings are issued, but not earlier. By that stage, of course, it is not normally practicable for a claimant to suddenly switch lawyers.

In its submissions to Lord Justice Jackson, the Law Society, at para 6.2 of chapter 8 of the Final Report:

> The three BTE issues which need to be resolved are:
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> i) The insured has no say in the terms of the contract between the insurer

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and the panel solicitor and therefore has less influence in the handling of the case than a client who does not have the benefit of BTE.

ii) The solicitor panels are restricted by insurers and there are frequently issues regarding the lack of freedom of choice of a client's own solicitor. The Law Society considers that freedom of choice of solicitor is important in the public interest. It is essential that the litigant should feel confidence in his or her legal advisers and will enhance the integrity of the system. Secondly, the litigant will be able to assess the competence of the firm directly and take action if dissatisfied.

iii) The definition of proceedings in the Regulations and how this is interpreted. The Law Society's view is that any extension of BTE should be subject to the agreement by insurers that the definition of 'proceedings' under the 1990 Regulations includes the pre-action protocol procedure or by clarification of those Regulations.

Lord Justice Jackson said, at para 6.3 of chapter 8:

> I see considerable force in the three specific concerns raised by the Law Society. In my view those concerns would all, in substance, be met if regulation 6 of the 1990 Regulations were amended to provide that the insured's right to choose a lawyer arises when a letter of claim is sent on his or her behalf to the opposing party.

A footnote to this text stated:

> Insurers may still use their own panel solicitors to investigate and assess the merits of claims. In practice, no doubt many insureds would be content to proceed thereafter using the same panel solicitors.

Lord Justice Jackson continued:

> However, before any such amendment of regulation 6 is considered, the effect upon BTE insurance premiums must first be considered. BTE insurers maintain that the present panel arrangements are beneficial in keeping costs down. I do not make this issue the subject matter of a recommendation. However, I place on record my support for making an amendment to regulation 6, as suggested above, if the impact of such an amendment on premiums turns out to be modest.

As no recommendation was made by Lord Justice Jackson in relation to BTE insurance, this question did not form part of the government recent green paper (consultation) on 'Proposals for Reform of Civil Litigation Funding and Costs in England and Wales'. However, it is plain that, in Lord Justice Jackson's view, reg 6 of the LEI Regulations does not entitle an insured to choose his or her own legal representative when a letter of claim is sent on his or her behalf, but only at the point of issuing proceedings (and, by implication, after the claim form and particulars of claim have been drafted by lawyers chosen by the legal expenses insurer, not by the insured).

It would be open to the European Court of Justice (and, indeed, to the English courts as the experts in English civil procedure) to interpret 'proceedings' in the LEI Directive as including any formal procedure governed by rules of court, which is a prerequisite to the issuing of formal court proceedings. Reg 6 of the LEI Regulations would then be interpreted in the same way, with no need for any amendment, and there would be no opportunity for the cost-benefit analysis contemplated by Lord Justice Jackson. If, as a result, legal expenses insurance premiums were to rise significantly and become unaffordable for many people, this would have obvious implications for the current debate concerning the funding of civil litigation in England and Wales.

Can the insurer dictate the terms of the lawyer's appointment?

Other issues that have received less publicity to date are no less contentious. In particular, once the right to choose a lawyer has arisen (whenever that may be), is the BTE legal expenses insurer entitled to impose terms on the lawyer's appointment? Insurers may require the lawyer to agree to their standard terms (for example, it appears that DAS require solicitors to agree to its 'DAS Non Panel PI Solicitor Terms of Appointment 2010' which, with appendices, extend to 48 pages (reproduced at Appendix 1 to the APIL Response, as above)). Allowing insurers a completely free hand in setting the terms is, in practice, likely to prevent any effective exercise of the right to choose a lawyer. Similarly, can a legal expenses insurer effectively prohibit the insured from using a lawyer of his choice unless that lawyer is prepared to agree to the same rates as the insurer's panel solicitors (who are likely to do the work at a significant discount to their usual rates in return for receiving bulk work by virtue of their membership of panel)?

These issues are in urgent need of clarification. In the March 2003 edition of Ombudsman News, the Financial Ombudsman Service was remarkably complacent, accepting that:

> ... we concluded that in providing policyholders with legal services by selecting a solicitor for them, from a pre-arranged panel, insurers are not generally either in clear conflict with the Regulations or inherently likely to be providing an inappropriate service, or one that is less effective than the alternatives that are likely to be available.
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> So in our view, there is generally nothing objectionable, from the policyholder's perspective, in insurers requiring policyholders (in most cases) to use the legal services of:
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> - the insurer's own (appropriately-trained) staff; *or*
> - a pre-selected panel of providers chosen by the insurer. [Emphasis added]

Future developments

Another reference to the European Court of Justice is currently pending (*Gebhard Stark v DAS Österreichische Allgemeine Rechtsschutzversicherung AG* [2010]). This is not directly concerned with either the stage at which the right to choose a lawyer arises, or the contractual terms of the appointment, but, as with *Eschig*, the Advocate-General's opinion, and the judgment, may give rise to useful observations on the interpretation of the LEI Directive, and therefore the LEI Regulations. ■

Erhard Eschig v UNIQA Sachversicherung
AG C-199/08 (judgment of the court of 10 September 2009)

Gebhard Stark v DAS Österreichische Allgemeine Rechtsschutzversicherung
AG (C-293/10)

Sarwar v Alam
[2001] EWCA Civ 1401

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