THE LAW REFORM COMMISSION OF HONG KONG

CONDITIONAL FEES SUB-COMMITTEE

CONSULTATION PAPER

CONDITIONAL FEES

This consultation paper can be found on the Internet at:
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September 2005

This Consultation Paper has been prepared by the Conditional Fees Sub-committee of the Law Reform Commission. It does not represent the final views of either the Sub-committee or the Law Reform Commission, and is circulated for comment and discussion only.

The Sub-committee would be grateful for comments on this Consultation Paper by 15 November 2005. All correspondence should be addressed to:

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It may be helpful for the Commission and the Sub-committee, either in discussion with others or in any subsequent report, to be able to refer to and attribute comments submitted in response to this Consultation Paper. Any request to treat all or part of a response in confidence will, of course, be respected, but if no such request is made, the Commission will assume that the response is not intended to be confidential.

It is the Commission's usual practice to acknowledge by name in the final report anyone who responds to a consultation paper. If you do not wish such an acknowledgement, please say so in your response.

THE LAW REFORM COMMISSION OF HONG KONG

SUB-COMMITTEE ON CONDITIONAL FEES

CONSULTATION PAPER

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Preface

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Terms of reference

1. In May 2003, the Secretary for Justice and the Chief Justice directed the Law Reform Commission:

> *"To consider whether in the circumstances of Hong Kong conditional fee arrangements are feasible and should be permitted for civil cases and, if so, to what extent (including for what types of cases and the features and limitations of any such arrangements) and to recommend such changes in the law as may be thought appropriate."*

The Sub-committee

2. The Sub-committee on Conditional Fees was appointed in July 2003 to consider and advise on the present state of the law and to make proposals for reform. The sub-committee members are:

Prof Edward K Y Chen, GBS, CBE, JP *(Chairman)*	President Lingnan University
Mr William H P Chan	Deputy Director Legal Aid Department
Mrs Pamela W S Chan, BBS, JP	Chief Executive Consumer Council
Mr Andrew Jeffries	Partner Allen & Overy, Solicitors
Mr Raymond Leung Hai-ming	Chief Executive Officer C & L Investment Company Ltd
Mr Raymond Leung Wai-man	Barrister Temple Chambers
Mr Kenneth S Y Ng	Head of Legal and Compliance Hongkong and Shanghai Banking Corporation

Mr Peter Schelling (from February 2004 to June 2005)	Managing Director & CEO Zurich Insurance Group (Hong Kong)
Mr Michael Scott	Senior Assistant Solicitor General Department of Justice
Mr Paul W T Shieh, SC	Senior Counsel Temple Chambers
Ms Sylvia W Y Siu	Consultant Solicitor Sit, Fung, Kwong & Shum
Ms Alice To Siu-kwan (from September 2003 to February 2004)	Assistant General Manager Technical Underwriting & Claims Royal & Sun Alliance Insurance (HK) Ltd
The Hon Madam Justice Yuen, JA	Justice of Appeal High Court
Ms Cathy Wan *(Secretary)*	Senior Government Counsel Law Reform Commission

3. The Sub-committee considered the reference over the course of nine meetings since July 2003 and will hold further meetings to discuss and evaluate comments on this consultation paper.

What are conditional fees?

4. A conditional or contingency fee agreement can be described as an agreement between a legal practitioner and his or her client to the effect that the legal practitioner will charge no fees if the client's court case is conducted unsuccessfully. The fees charged under this type of agreement are sometimes referred to as "event-triggered fees", and the basis for charging legal costs is known as "no success, no pay" or "no win, no fee". This type of fee arrangement is usually allowed only in civil litigation cases, although the scope of application differs amongst jurisdictions. In most jurisdictions, the costs indemnity rule applies, meaning that the unsuccessful party has to pay the costs of the successful party. Conditional or contingency agreements do not relieve the litigant from the risk of an adverse costs order to pay the other side's legal costs if the litigation is unsuccessful.

Terminology

5. There are various ways in which event-triggered fees can be applied, and the amount of fees that become payable in the event of success

will vary accordingly. Terms used to denote these different methods of charging include contingency fees, uplift fees, speculative fees, and percentage fees. These terms are not consistently applied in the literature on the topic. For the purposes of this paper, these terms have the meaning ascribed to them below.

Contingency fee, percentage fee, "no win, no fee"

6. In some literature[1] the term "contingency fee" is given a wide meaning and includes any type of calculation on a "no win, no fee" basis. However, in other contexts, "contingency fee" is taken to mean "percentage fee", whereby the lawyer's fee is calculated as a percentage of the amount awarded by the court. This is the basis adopted in the USA. For the purposes of this paper, we use the term "contingency fees" to mean only "percentage fees", whereas the term "event-triggered fees" embraces all the different "no win, no fee" bases of calculation.

Conditional fee, uplift fee, success fee

7. The term "conditional fee" is sometimes loosely used to mean event-triggered fees. However, in other contexts, and also for the purposes of this paper, "conditional fee" means an arrangement whereby, in the event of success, the lawyer charges his usual fee plus an agreed flat amount or percentage "uplift" on the usual fee. The additional fee is often referred to as an "uplift fee" or a "success fee". Conditional fee agreements have been allowed in the UK since 1995, and also in the Australian jurisdictions of Victoria, South Australia, New South Wales and Queensland.

Speculative fee

8. Where a "speculative fee" is charged, the lawyer is entitled to charge only his or her normal fee in the event of successful litigation. Where the action does not succeed, the lawyer is not entitled to a fee. Speculative fees have been used in Scotland for a long time.

Layout of this paper

9. The first chapter sets out the sources of litigation finance in Hong Kong, and the rules which apply to the allocation of costs. Chapter 2 examines the application of contingency fees in the USA, while Chapters 3 and

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[1] For example, South African Law Commission, *Report on Speculative and Contingency Fees*, Project No 93, November 1996. Contrast, however, with Australian Law Reform Commission, *Costs shifting – who pays for litigation* (1995, Report No 75), footnote 20 on p 36, *"A contingency arrangement provides that, if the action succeeds, the lawyer receives the usual fee plus an agreed extra amount. If that amount is a flat amount or a percentage of the usual fee it is called an 'uplift' contingency fee. If it is a percentage of the damages award it is called a 'percentage' contingency fee."*

4 look at the development of conditional fees in England and recent problems and litigation there. Chapter 5 turns to the experience of event-triggered fees in a number of other jurisdictions, and Chapter 6 deals with the arguments for and against conditional fees and sets out related issues for discussion. The Sub-committee's recommendations are set out in Chapter 7, while Chapter 8 contains a summary of the recommendations.

Chapter 1

The costs of litigation

Who pays for litigation?

1.1 The costs of litigation in courts and tribunals are met from a number of different sources. The principal sources of finance for litigation are discussed below.[1]

1.2 *Insurance* – Insurance companies are major participants in litigation, particularly in personal injury cases, where the dispute usually concerns the amount of damages rather than liability. In cases where the courts order the defendant to pay the plaintiff's costs pursuant to the cost indemnity rule,[2] these costs are often paid by the defendant's insurance company in accordance with the insurance policy. In some jurisdictions, litigation costs are paid out of legal expense insurance schemes. These are common in Europe and in the United States, and growing in number in Canada and the United Kingdom.[3] In Sweden, for example, legal expense insurance was introduced in 1961 and is now an obligatory part of householders' comprehensive insurance. It is reported that 70% of Sweden's population is protected by legal expense insurance, and 84% of total litigation costs are paid out of insurance. Such schemes provide cover to individuals for the costs of litigation in the courts (but not tribunals) in relation to disputes that arise in their everyday relations, except for divorce proceedings and disputes arising from an occupation for gain other than regular work.[4] The cover indemnifies the litigant for his own costs and the costs of the other party that the litigant might be required to pay.[5]

1.3 *Legal aid* – The Legal Aid Department in Hong Kong provides assistance to litigants who satisfy the relevant means and merits tests, if their type of case is covered by the legal aid schemes.[6] The legal aid schemes cover both criminal and civil cases, the latter mainly in relation to matrimonial disputes, personal injury and running-down cases. In 2003, 21,643 applications for civil legal aid were received and 10,694 of them were granted. The Legal Aid Department's expenditure on civil cases was $343 million that year, and $769 million was recovered for the aided persons. As for criminal

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1 The categorisation largely follows that of the Australian Law Reform Commission, *Costs shifting – who pays for litigation* (1995, Report No 75), at 35-40.

2 The "cost indemnity rule" is discussed later in this chapter.

3 Law Reform Commission of Victoria, *The Cost of Litigation* (May 1990), at 39.

4 As above.

5 As above.

6 Legal aid in Hong Kong will be discussed in greater detail later in this chapter.

legal aid, the same year recorded 4,411 applications, with 2,803 of them granted, for an expenditure of $89 million.[7]

1.4 *Tax deductions* – The Australian Law Reform Commission[8] pointed out that businesses are major users of the court system, and that legal expenses incurred are generally tax deductible. The ALRC's consultation exercise revealed that many people saw the tax deductions available to business litigants as inherently inequitable because they were not also available to individual litigants. The business litigant who does not have to bear the full cost of litigation can therefore afford to engage more readily in litigation, to prolong the litigation, and to hire more expensive representation. Individuals who qualify for legal aid must undergo a strict merits and means test, whereas business litigants are eligible for tax deductions without any assessment of the merit or reasonableness of the legal expense.[9]

1.5 *Legal practitioners* – In jurisdictions which allow event-triggered fees, the litigation costs of unsuccessful cases are borne by the legal practitioners. The level of utilisation of contingency or conditional fees differs from jurisdiction to jurisdiction. The Australian Law Reform Commission observed[10] that in Australia speculative and contingency fee arrangements are commonly used by plaintiffs' lawyers in personal injury cases. They are also used, although less frequently, for other claims for damages. Occasionally they are used where non-monetary relief, such as a declaration or injunction, is sought. In Scotland, by contrast, it is estimated that only about 1% of all cases are charged on a speculative basis.[11] As for the United States, in the absence of legal aid, contingency fees are one of the principal sources of financing for litigation.

1.6 *Claims Intermediaries* – These are businesses run by non-legally qualified persons that help clients handle their compensation claims, usually those arising from traffic or work-related accidents. They operate on a "no win, no fee" basis, and usually require payment of 20% – 30% of the compensation received if the claim is successful. Claims intermediaries have proliferated in England, and are operating in Hong Kong. Given that the common law offences of maintenance and champerty are still applicable to Hong Kong, in some circumstances the activities of some compensation claims agents might be unlawful. Those claims intermediaries who act within the law offer a convenient service to the public, although the public should be aware that these agents are un-regulated. This issue will be discussed in greater detail later in this paper.

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7 *Hong Kong Year Book 2003* <www.info.gov.hk/yearbook/2003>.

8 Report No 75 at 38-40.

9 In answer to suggestions that individuals too should enjoy tax deduction for legal expenses, the ALRC, however, has rightly pointed out that tax deductions are different in nature from other sources of litigation costs, and that the tax system is designed to meet economic and other objectives. It seems, therefore, the question whether individuals should enjoy tax deduction for legal expenses requires more in-depth consideration.

10 Report No 75 at 36.

11 South African Law Commission, *Report on Speculative and Contingency Fees* (1996), at para 2.17.

1.7 *Litigants* – The parties' own resources are the most obvious source of finance for litigation. The costs rules determine which litigant shall pay how much, and the basis for determination of costs.

Relevant costs rules in Hong Kong

1.8 To assess the impact of the introduction of any event-triggered fees in Hong Kong, it is useful to set out an overview of the relevant costs rules. The word "costs" is sometimes used to denote the remuneration which a party pays to his own solicitor. It also means the sum of money which the court orders one litigant to pay to another to compensate the latter for the expense which he has incurred in litigation. Relevant costs rules in Hong Kong are found in Order 62 of the Rules of the High Court (Cap 4A), which applies to contentious proceedings.[12]

Costs to follow the event[13] *- the costs indemnity rule*

1.9 If in the exercise of its discretion the Court sees fit to make any order as to the costs of, or incidental to, any proceedings, the Court will order the costs "to follow the event",[14] except when it appears that some other order should be made as to the whole or any part of the costs. This means that the unsuccessful litigant will usually be ordered to pay the legal costs of the successful party,[15] in addition to paying his own legal costs. This rule is referred to as the "costs indemnity rule",[16] and is also the basic costs allocation rule for civil proceedings in the United Kingdom, Canada, Japan and most European countries.[17] The principal exception is the United States, where the general rule is that each party must pay his or her own costs, except where the litigation is vexatious or an abuse of process.[18]

1.10 Considerations which justify the costs indemnity rule are that it:

- deters vexatious, frivolous or unmeritorious claims or defences;[19]
- compensates successful litigants for at least some of the costs they incur in litigating;
- encourages settlement of disputes by adding to the amount at stake in the litigation;[20] and

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12 Subject to some exceptions. Order 60, r 2.

13 This rule is under review. In the *Civil Justice Reform Interim Report and Consultation Paper*, published by the Chief Justice's Working Party on Civil Justice Reform Nov 2001, there are discussions on whether costs should be awarded flexibly throughout the proceedings to act as an incentive for reasonable litigant behaviour. See Proposal 51.

14 Ord 62 r 3.

15 However, the amount of costs awarded by the court to the successful litigant seldom repays his full outlay. This concerns the bases of taxation by the court and will be discussed later in this chapter.

16 This is different from 'costs on the indemnity basis' which will be discussed later in this chapter.

17 ALRC, cited above, at para 4.3.

18 As above.

19 The cost indemnity rule, however, is also said to deter people with meritorious claims or defences from pursuing them.

- in jurisdictions which allow event-triggered fees it is regarded as one source for financing litigation, especially where it is certain that the other party has the resources to meet the costs orders.

1.11 Although costs follow the event, the successful litigant seldom recovers his whole outlay. Unless agreed, the costs have to be assessed (or "taxed") by the court. Unlike the position in England,[21] there are five bases for taxation of costs in Hong Kong under the Rules of the High Court: party and party, common fund, trustee, indemnity, and solicitor and own client.

Bases of taxation in Hong Kong

Costs on the party and party basis

1.12 This is the most common basis for the assessment of costs. On a taxation on this basis, all "*costs as were necessary or proper for the attainment of justice or for enforcing or defending the rights of the party whose costs are being taxed*" will be allowed.[22] The principle upon which costs are taxed on this basis is that the successful party should be indemnified against the necessary expense to which he has been put in prosecuting or defending the action, although costs incurred in conducting the litigation more conveniently are not included.[23] It has been said that "*it is a fiction that taxed costs are the same as costs reasonably incurred*",[24] and in the words of Godfrey J in *Wharf Properties Ltd v Eric Cumine Associates*,[25] party and party costs are "*the bread but not the butter*".

Costs on the common fund basis

1.13 This is a more generous basis than the party and party basis, and "*a reasonable amount in respect of all costs reasonably incurred*" is allowed.[26] In awarding costs which are to be paid out of any fund, except a fund which the party holds as trustee or personal representative, the court may,

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20 There is, however, no agreement amongst the studies whether the net settlement rate is higher or lower under the costs indemnity rule than under the American rule. ALRC, cited above, at para 4.6.

21 *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1223. Costs in England are now assessed either on the standard basis or the indemnity basis: see the English Rules of the High Court ("English RHC"), Ord 62 r 3(4). On the standard basis, a reasonable amount is allowed in respect of all costs reasonably incurred and any doubt which the taxing master has as to whether the costs were reasonably incurred or were reasonable in amount is resolved in favour of the paying party: English RHC, Ord 62 r 12(1). On a taxation of costs on the indemnity basis, all costs are allowed except in so far as they are of an unreasonable amount or have been unreasonably incurred and any doubts which the taxing master may have as to whether the costs were reasonably incurred or were reasonable in amount is resolved in favour of the receiving party: English RHC, Ord 62 r 12(2).

22 Ord 62 r 28(2).

23 *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1224. See also *Smith v Buller* (1875) LR 19 Eq 473, where such extra costs were described as luxuries which must be paid for by the party incurring them.

24 As above.

25 Unreported; Comm L 48/1985.

26 Ord 62 r 28(4).

if it thinks fit, order that the costs be taxed on the common fund basis. Legal aid costs, for example, are assessed on the common fund basis upon taxation as between the legally aided person and the Director of Legal Aid.[27] Other examples are costs awarded in favour of persons under a disability as a result of a settlement approved by the court, and costs awarded to ensure that the next friend of an infant plaintiff is not out of pocket.[28]

Costs on the indemnity basis

1.14 In awarding costs on an indemnity basis, all costs will be allowed except in so far as they are of an unreasonable amount or have been unreasonably incurred.[29] Any doubts which the taxing master may have as to whether the costs were reasonably incurred or were reasonable in amount must be resolved in favour of the receiving party.[30] Circumstances which justify an award on an indemnity basis include cases which are brought with an ulterior motive or for an improper purpose, cases conducted in an oppressive manner, and cases where there has been some deception or underhand conduct on the part of the litigant.[31] Costs on an indemnity basis have also been awarded in cases "*where there has been an abuse of the court's process, contempt of court, and for failure to make full and frank disclosure in an affidavit in support of an ex parte application.*"[32]

Costs as between a solicitor and his own client

1.15 On a taxation of a solicitor's bill to his own client,[33] all costs must be allowed except in so far as they are of an unreasonable amount or have been unreasonably incurred.[34] Costs incurred with the express or implied approval of the client are conclusively presumed to have been reasonably incurred and; where the amount thereof has been expressly or impliedly approved by the client, it is conclusively presumed to have been reasonable in amount.[35] On the other hand, costs which in the circumstances of the case are of an unusual nature and such that they would not be allowed on a taxation

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27 *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1225 and footnote 15. The Legal Aid Ordinance (Cap 91), s 20A(1) provides that on the taxation of costs in proceedings in which an aided person is a party, costs must be taxed for the purposes of the Legal Aid Ordinance according to the ordinary rules applicable on a taxation as between solicitor and client where the costs are to be paid out of a common fund in which the client and others are interested. The effect of this provision is that the costs of any solicitor or counsel retained by the Department of Legal Aid to act on behalf of an aided person are taxed on the common fund basis. This does not affect the other party to the action and the costs as between the legally aided person and the other party are taxed on the usual party and party basis. The party and party taxation between the two parties to the litigation and the common fund taxation as between the legal representative and legal aid are normally conducted at the same time.

28 *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1225.

29 Ord 62 r 28(4A).

30 As above. Also *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1226.

31 As above, at para 90.1226.

32 As above.

33 Except a bill to be paid out of the legal aid fund pursuant to s 27 Legal Aid Ordinance (Cap 91), or a bill relating to non-contentious business.

34 Ord 62 r 29(1).

35 Ord 62 r 29(2).

on a party and party basis are presumed to have been unreasonably incurred until the contrary is shown, unless the solicitor expressly informed his client before the costs were incurred that they might not be allowed.[36]

1.16 On occasions, the court has ordered costs as between opposing parties to be taxed on the solicitor and own client basis, and parties are free to contract that costs between them will be assessed on this basis.[37]

Costs on the trustee basis

1.17 In earlier days, trustees and personal representatives were awarded costs on what is now the common fund basis.[38] Now a more generous basis is made available to them. For costs assessed on the trustee basis, no costs will be disallowed except in so far as they, or any part of their amount, should not, in accordance with the duty of the trustee or personal representative as such, have been incurred by him, and should for that reason be borne by him personally.[39]

Other costs aspects

1.18 Having examined the five methods of taxation, we will briefly set out how counsel's fees and the costs of the litigant in person are assessed.

Counsel's fees

1.19 Every fee paid to counsel must be allowed in full on taxation unless the taxing master is satisfied that it is excessive or unreasonable. In that case, the taxing master must exercise his discretion having regard to all the relevant circumstances.[40] He must have regard in particular to:

(a) the complexity or novelty of the matter;
(b) the skill, specialised knowledge and responsibility required, and the time and labour expended;
(c) the number and importance of the documents prepared or perused;
(d) the place and circumstances in which the business is transacted;
(e) the importance of the matter to the client;
(f) the amount or value of the money or property involved; and
(g) any other fees payable to the counsel in respect of other items in the same matter, but only where the work done in relation to those other items has reduced the work which would otherwise have been necessary in relation to the item in question.[41]

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36 Ord 62 r 29(3). *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1227.
37 *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1227.
38 *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1228.
39 Ord 62 r 31(2). See also *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1228.
40 Ord 62, Sch 1, Part II, para 2(HK)(5).
41 Ord 62, Sch 1, Part II, para 1(2).

Costs of litigant in person

1.20 On a taxation of the costs of a litigant in person, subject to some exceptions, there may "*be allowed such costs as would have been allowed if the work and disbursements to which the costs relate had been done or made by a solicitor on the litigant's behalf.*"[42] Except for disbursements, the amount allowed in respect of any item shall be at the taxing master's discretion and not exceeding two-thirds of the sum which would normally be allowed if the litigant had been represented by a solicitor.[43] The litigant in person would not normally be allowed more than $200 an hour in respect of the time reasonably spent by him on the work.[44]

Legal aid as a source of finance for civil litigation

1.21 Legal aid is available for most types of civil cases[45] before the District Court, the Court of First Instance, the Court of Appeal and the Court of Final Appeal. It is also available for certain landlord and tenant matters[46] in the Lands Tribunal, proceedings before the Mental Health Review Tribunal, and in the Coroner's Court if the case is of great public concern.[47] The Legal Aid Department is funded by the Government of the Hong Kong SAR, and the provision for legal costs is not subject to an upper limit. In 2003, the Legal Aid Department's expenditure on civil cases was $343 million, and $769 million was recovered for the aided persons.[48]

The merits test

1.22 To qualify for civil legal aid, the applicant must pass a merits test and a means test. In assessing the merits of an application, the Director of Legal Aid ("the Director") must be satisfied that the case or defence has a reasonable chance of success. The Director must also be satisfied that it is reasonable that the applicant should be granted aid, and he will take into account all factors which would influence a private client considering taking proceedings.[49] Therefore, legal aid may be refused if, for example, the benefits to be obtained in the proceedings do not justify the likely costs, or it is unlikely that a judgment could be enforced because the opposite party is uninsured or has no valuable asset or cannot be located.[50] For cases where the benefits cannot be measured in purely monetary terms, the Director will

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42 Ord 62 r 28A(1).

43 Ord 62 r 28A(2).

44 Ord 62 r 28A(3).

45 Legal aid is also available for criminal cases tried in District Courts and upwards. It is not available in the Magistrate's Court for cases other than committal proceedings, given that the Duty Lawyer service is available at the Magistrate's Courts.

46 Part II tenancy matters only.

47 Legal Aid Ordinance (Cap 91), section 5, and Schedule 2 Part I. See also *Halsbury's Laws of Hong Kong*, Vol 17, para 240.331.

48 *Hong Kong Year Book 2003*. As for criminal cases, total expenditure was $89 million.

49 Legal Aid Department, *Guide to Legal Aid Services in Hong Kong*, at 13.

50 Legal Aid Department, cited above, at 14.

make an objective and careful assessment and due weight will be given to the importance of the case to the applicant.[51]

The means test

1.23 The means test evaluates whether an applicant's financial resources exceed the statutory limit allowed for the relevant legal aid scheme.[52] Financial resources are taken as an applicant's monthly disposable income multiplied by 12, plus his or her disposable capital.

1.24 Monthly disposable income is the difference between gross monthly income and allowable deductions, which are rent, rates and statutory personal allowances[53] for the living expenses of the applicant or his or her dependants.

1.25 Disposable capital consists of all assets of a capital nature, such as cash, bank savings, jewellery, antiques, stocks and shares and property. Excluded from the calculation of capital are, for example, the applicant's residence, household furniture, and implements of the applicant's trade. Negative equity in a real property is treated as having no value in the assessment of disposable capital.[54]

Ordinary Legal Aid Scheme

1.26 To qualify for legal aid for civil proceedings under the Ordinary Legal Aid Scheme, the applicant's financial resources[55] must not exceed $155,800.[56] The major types of cases covered by the Ordinary Legal Aid Scheme are:

- family and matrimonial disputes 31%[57]
- miscellaneous personal injury claims 23%
- running down actions 8%
- employees' compensation 8%

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51 Legal Aid Department, cited above, at 15.

52 The three legal aid schemes, being ordinary legal aid, supplementary legal aid and criminal legal aid will be discussed later in this chapter.

53 The statutory personal allowance is periodically adjusted in line with the Consumer Price Index and the Household Expenditure Survey conducted by the Census and Statistics Department. As at July 2004, the statutory personal allowance amounts for a single applicant and an applicant with one dependant are $3,780 and $6,880 respectively. The maximum amount is $16,060 for an applicant with six or more dependants.

54 *Ng Ai Kheng Jasmine v Master M Yuen & Legal Aid Department*, HCAL 46 of 2003 (unrep), 8 March 2004. The court decided that the relevant rules do not permit the negative value of a property, being in its true nature a financial liability, to be included in the computation of disposable capital. The amount to be attached to such a property is zero.

55 Legal Aid Ordinance (Cap 91), s 5. Please also refer to preceding paragraphs to see how 'financial resources' are calculated.

56 The upper limit of financial eligibility may be waived in meritorious cases involving a possible breach of the Hong Kong Bill of Rights Ordinance (Cap 383) or an inconsistency with the International Covenant on Civil and Political Rights. Legal Aid Ordinance (Cap 91), s 5AA.

57 Percentage of total expenditure on civil legal aid for 2002/03. *Legal Aid Departmental Report 2003*.

- wages claim 4%
- immigration matters 2%
- tenancy matters 1%
- miscellaneous 23%

1.27 Legal aid is not available[58] for certain proceedings, including:

- defamation (other than defending a counter-claim alleging defamation)
- Small Claims Tribunal matters
- Labour Tribunal matters
- Money claims in derivatives of securities, currency futures or other futures contracts

1.28 A person receiving legal aid will be required to contribute towards the legal costs of the proceedings out of his financial resources and/or the money or property recovered or preserved on his behalf. Applicants whose financial resources are assessed as between $20,001 and $155,800 are required to make a contribution on a sliding scale ranging from $1,000 to $38,950 (ie 25% of $155,800).[59] Where no contribution is payable, or the contribution paid does not cover the legal costs incurred on behalf of an aided person (including legal costs which cannot be recovered from the opposite party), the Director has a right to recover the costs or any shortfall from any property recovered or preserved in the proceedings. This right is known as the Director of Legal Aid's first charge. If the aided person loses the case, he is liable to pay the assessed maximum contribution or the actual legal costs incurred in the proceedings, whichever is lower.

1.29 The Director is required to pay to the counsel and solicitor acting for an aided person the prescribed fees and costs under the Legal Aid (Scale of Fees) Regulations.[60] On taxation of costs in proceedings to which an aided person is a party, costs are taxed according to the ordinary rules applicable as between solicitor and client where the costs are to be paid out of a common fund in which the client and others are interested.[61]

Supplementary Legal Aid Scheme

1.30 The Supplementary Legal Aid Scheme was introduced in 1984[62] to assist members of the so-called "sandwich class" who would otherwise be outside the means test for the ordinary scheme.[63] This scheme is available for applicants whose financial resources exceed $155,800 but do not exceed $432,900. Unlike the Ordinary Legal Aid Scheme, the Supplementary Legal

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58 See Legal Aid Ordinance (Cap 91) Sch 2, Part II.

59 Schedule 3 to the Legal Aid (Assessment of Resources and Contributions) Regulations, Cap 91B.

60 (Cap 91 C) pursuant to s 28 of Legal Aid Ordinance (Cap 91).

61 Section 20A(1).

62 Legal Aid (Amendment) Ordinance 1984 (Ord No 54 of 1984), which came into effect on 1 Oct 1984.

63 *Halsbury's Laws of Hong Kong*, Vol 17, para 240.348.

Aid Scheme is self-financing. The costs of the scheme are met from the Supplementary Legal Aid Fund, which is funded by applicants' contributions and damages or compensation recovered. In 2003, 106 applications for supplementary legal aid were received of which 79 applications were approved. Expenditure was $23 million and $61 million was recovered on behalf of the aided persons.[64]

1.31 Supplementary legal aid is available for a range of cases[65] including personal injury or death, as well as medical, dental or legal professional negligence where the claim for damages is likely to exceed $60,000. The scheme also covers claims under the Employees' Compensation Ordinance irrespective of the amount of the claim.

1.32 Where legal aid is granted to an applicant under the Supplementary Legal Aid Scheme, he is required to pay an initial application fee[66] and an interim contribution for the benefit of the Fund.[67] If he is successful, he will have to make a final contribution calculated as follows:

> All costs and expenses incurred on his account plus 'percentage deduction' being, as at July 2004, 12% or 6% of the damages awarded depending on whether the case is settled prior to delivery of a brief to Counsel to attend trial.
>
> <u>less</u>
>
> The interim contribution and application fee already paid, and the costs recovered from the opposite party.

1.33 The contribution payable must not exceed the value of the property recovered or preserved in the proceedings,[68] and the Director may waive, either in whole or in part, his rights to a contribution where he is satisfied that it would cause serious hardship and it is in all the circumstances just and equitable to do so.[69]

Criminal Legal Aid

1.34 For the purpose of this paper, criminal legal aid will be discussed only briefly. Applicants for criminal legal aid have to pass the means test under the same financial resources criteria as for civil cases.[70] An applicant charged with murder, treason or piracy with violence can apply to a judge for exemption from the means test and from legal aid contribution.[71] The

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64 *Hong Kong Year Book 2003*.

65 Legal Aid Ordinance (Cap 91), s 5A, Sch 3, Part I. The Schedule may be amended by resolution of the Legislative Council.

66 $1,000 as at July 2004.

67 Legal Aid Ordinance (Cap 91), s 32(1)(a).

68 Section 32(2).

69 Section 32(3).

70 Rule 4 of the Legal Aid in Criminal Cases Rules (Cap 221D).

71 Rule 13 of the Legal Aid in Criminal Cases Rules (Cap 221D).

Director has a discretion to grant criminal legal aid to an applicant whose financial resources exceed $155,800 if it is in the interests of justice to do so.[72]

1.35 In the interests of justice, legal representation will be provided to an accused for committal proceedings and for trials in the District Court and the Court of First Instance as long as he passes the means test. However, for criminal appeals, the merits test will apply, except for murder, treason or piracy with violence. There is a statutory requirement to grant legal aid in such cases even if there are no meritorious grounds for appeal.[73]

Provisions against conditional or contingency fee arrangements in Hong Kong

1.36 In Hong Kong, a solicitor may not enter into a conditional or contingency fee arrangement to act in contentious business.[74] The restriction stems from legislation, conduct rules, and common law. In *Cannonway Consultants Ltd v Kenworth Engineering Ltd*,[75] Kaplan J explained that the law of champerty applied in Hong Kong by virtue of section 3(1) of the Application of English Law Ordinance, although the doctrine was of narrow extent. The common law position will be set out in Chapters 3 and 4.

1.37 The Legal Practitioners Ordinance (Cap 159)[76] provides that the power to make agreements as to remuneration and the provisions for the enforcement of these agreements do not give validity to "*any agreement by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding stipulates for payment only in the event of success in that action, suit or proceeding.*"[77]

1.38 The *Hong Kong Solicitors' Guide to Professional Conduct* issued by the Law Society of Hong Kong stipulates that "*A solicitor may not enter into a contingency fee arrangement for acting in contentious proceedings.*"[78] The Guide's commentary defines a contingency fee arrangement as:

> *"any arrangement whereby a solicitor is to be rewarded only in the event of success in litigation by the payment of any sum (whether fixed, or calculated either as a percentage of the proceeds or otherwise). This is so, even if the agreement further stipulates a minimum fee in any case, win or lose."*

1.39 The commentary further explains that the principle only extends to agreements which involve the institution of proceedings and:

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72 Rule 15(2) of Cap 221D.

73 As above.

74 *Halsbury's Laws of Hong Kong*, Vol 17, para 240.125. 'Contentious business' includes any business done by a solicitor in any court, whether as a solicitor or as an advocate : Legal Practitioners Ordinance (Cap 159), s 2(1).

75 ADRLJ, 1997, at 95-105.

76 Section 64(1).

77 Subsection (b).

78 Principle 4.16.

> *"it would not be unlawful for a solicitor to enter into an agreement on a commission basis to recover debts due to a client, provided that the agreement is limited strictly to debts which are recovered without the institution of legal proceedings."*

1.40 As for barristers, they are under a professional duty to observe the rules of conduct set out in the *Code of Conduct for the Bar of Hong Kong*,[79] which is published by the Bar Council. Paragraph 124 of the Code of Conduct stipulates that "*A barrister may not accept a brief or instructions on terms that payment of fees shall be postponed or shall depend upon or be related to a contingency.*"

1.41 Serious failure to comply with the Code of Conduct amounts to professional misconduct and, if so found by a Barristers Disciplinary Tribunal, renders the barrister liable to be punished in accordance with the provisions of the Legal Practitioners Ordinance (Cap 159).[80] A less serious breach of the Code of Conduct which does not, in the opinion of the Bar Council amount to professional misconduct will be regarded as a breach of professional standards, and may render the barrister liable to be admonished in person or by letter, or to be given appropriate advice as to his future conduct.

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[79] Paragraph 6 of the Bar's Code of Conduct provides that it is the duty of every barrister to comply with the provisions of the Code.

[80] As above, at para 7.

Chapter 2

Contingency fee arrangements in the USA

Introduction

2.1 No jurisdiction other than those in the United States operates an extensive contingency fee system,[1] and the extent of the contingency fee's use there is unmatched by any other country.[2] The longstanding and general acceptance of contingency fees can be dated back to 1850 when the Supreme Court recognised the validity of contingency fee contracts. There are, however, differences among the 50 states in the operation and control of the contingency fee schemes.

2.2 According to the Green Paper prepared by the UK Lord Chancellor's Department in 1989, the State of Maine, for example, prohibits contingency fees entirely, whereas in New York, Michigan and Delaware, statute has overruled initial restrictions against contingency fees.[3] Contingency fees are not prohibited in New Jersey, Alabama, Ohio and California, but they are subject to limitations and controls. In another study[4] in 1992, it was stated that all 50 states allow contingency fee arrangements.

2.3 What is not disputed is that contingency fees are the primary financing arrangements in personal injury and other tort litigation. Contingency fees are used most frequently in personal injury cases where the potential awards are greatest. One source noted that 95% of personal injury plaintiffs utilise contingent fee arrangements.[5] Some lawyers may also be willing to charge on a contingency basis for debt recovery, workmen's compensation, corporate business practice, taxation, land compensation and contested will.[6] However, the use of contingency fees is proscribed in certain areas on the grounds of public policy. It is noted that the *Disciplinary Rules of the Code of Professional Responsibility* (CPR) prohibit the use of contingency fee arrangements in criminal matters, and that the Ethical Considerations of the CPR advise that contingency fees are not appropriate for domestic or matrimonial cases.[7]

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1 UK Lord Chancellor's Department, *Contingency Fees* (1989 : Cm 571), para 2.13.

2 Aranson, *"The United States Percentage Contingent Fee System : Ridicule and Reform From an International Perspective"* (1992) 27 Texas International Law Journal 755.

3 UK Lord Chancellor's Department, cited above, para 2.8.

4 Aranson, cited above.

5 J Kakalik & N Pace, *Costs and Compensation Paid in Tort Litigation* (1986) quoted at footnote 12 by R M Birnholz, "The Validity and Propriety of Contingent Fee Controls" (1990) 37 UCLA Law Review 949.

6 UK Lord Chancellor's Department, cited above, para 2.9.

7 As above, para 2.10.

The percentage contingency fee

2.4 Although various methods and formulae are adopted in different states to fix the contingency fee, the most common basis for charging contingency fees in the USA is as a percentage of the sum recovered.[8] There are variations, however, even within the percentage contingency fee schemes. The lawyer and his client may agree to apply a fixed percentage rate to the whole sum recovered. Alternatively, they may agree a changing percentage rate as the amount recovered increases, depending on the additional skill and effort required. Parties may also agree a series of increasing percentage rates applied to the recovery, depending on the stage reached in the proceedings.[9]

2.5 The United States contingent fee system has been described as "extraordinary" in nature.[10] The United States is the only country which allows a lawyer to receive a percentage of an award or settlement as a fee. A typical contingent fee arrangement may provide that the attorney's fee will constitute 25% of the amount recovered if the case settles, or 30% if the case proceeds to trial. As an example of excessive fees which go beyond adequate compensation for the lawyers' services and risks, Aranson cites the case of *Pennzoil v Texaco*[11] which resulted in a $10 billion award for Pennzoil, and $2 billion for their lawyers.

2.6 Understandably, the contingency fee system has come under criticism and initiatives proposing a ceiling on contingency fees in tort actions have been launched. Birnholz[12] noted that in response to the perceived crisis concerning the affordability of health care services throughout the United States, many state legislatures have enacted comprehensive statutory schemes designed to lower medical malpractice insurance premiums and regulate malpractices in litigation. An example of such a scheme is the Medical Injury Compensation Reform Act in California. Typically, these schemes contain provisions that limit the amount an attorney can charge on a contingency fee basis in actions against health care providers. At the time of the article, New Jersey allowed fees amounting to 33% of the first $250,000 recovered, 25% of the next $250,000, and 20% of the next $500,000. The fees allowed in California were 25% of amounts recovered between $100,000 and $500,000, and 15% of amounts above $600,000.

2.7 Critics of the US contingency fee system have described it as nothing more than a "lottery ticket" that brings the "*jury system into contempt"* and creates a *"feeling of antagonism between aggregated capital on the one side and the community in general on the other …*"[13]. Aranson[14] is one such

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8 As above, para 2.12.
9 As above.
10 Aranson, cited above.
11 729 S.W. 2d 768 (Tex. App. – Houston [1st Dist.] 1987).
12 Birnholz, cited above.
13 "The Contingent Fee Business", 24 Alberta Law Journal 24, 26 (1881), quoted in Aranson, cited above.
14 Aranson, cited above.

critic of the American percentage contingent fee system. He believes that under a percentage contingent fee, lawyers are more likely to choose to represent clients with frivolous claims, to pursue cases with their own interests in mind rather than their clients' (conflict of interest), and to charge excessive fees:

- *Frivolous litigation* – Lawyers can afford to file groundless cases by using the substantial funds gained from successful contingent cases to front the litigation costs. Hence, lawyers can gamble that a baseless claim will be profitable because of the pressure on the defendant to settle. Cases are therefore taken on for their settlement value, not their merits. In one Agent Orange case,[15] although the judge remarked, *"I'm not going to reward lawyers for bringing a case … with no factual connection … between the disease and the alleged cause. I do not believe it desirable to encourage cases like this"*, the chemical companies settled out of fear of a jury verdict that might run to billions of dollars. The plaintiffs' lawyers in this case asked for 14% (less than the standard one third) of the $180 million settlement, amounting to a legal fee of $26 million. This aspect of the contingent fee system in the US stems from other unique features of the American civil litigation system which are examined later in this chapter.

- *Conflict of interest* – Whilst the contingency or conditional fee system in general may align the lawyer's and the client's interest because both want to seek the highest recovery possible, a conflict arises if the lawyer wants the highest recovery in the shortest time possible. It should be noted that the vast majority of cases engaged on a contingent fee basis settle. By settling a case quickly, a lawyer can receive a large fee without expending much time on the case.[16]

- *Excessive fees* – Critics believe that the fees charged by contingency fee lawyers are excessive and not justified. Contingency fee lawyers often defend their fees by saying they risk losing the case and receiving no payment at all. Yet the high contingent fee does not reflect the actual risk of loss. Over 90% of cases taken on a contingent fee basis settle before trial, and only 50% of those that go to trial result in an adverse verdict. Therefore, on average, the attorney risks losing in only 5% of cases.

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15 *In Re Agent Orange Product Liability*, 100 FRD 718 (EDNY 1983).

16 Aranson gave the following example: "*A lawyer may decide that the true worth of a claim is $100,000 which will require 100 hours of work to obtain. The lawyer will receive one-third of the award as a fee, $33,000. After 5 hours of work, the insurance company offers $15,000 to settle, the lawyer receiving one-third, $5,000. The lawyer who accepts the settlement will receive a fee of $1,000 an hour, as opposed to $330 an hour if the case goes to trial.*"

Other unique features of the American civil justice system

2.8 In order to ascertain whether the high level of litigation and awards in the United States civil justice system are the product of contingency fees alone, or other factors, it is necessary to examine other features of the American civil justice system.

Costs do not follow the event

2.9 The basic cost allocation rule in most jurisdictions is that the losing litigant must pay not only his or her own costs, but also those of the winner, or at least part of the winner's costs. We have pointed out[17] that this costs indemnity rule is adopted for civil proceedings in Canada, Japan, Hong Kong, the United Kingdom and most European jurisdictions, including Austria, Belgium, Denmark, France, Norway, Spain, Sweden and Zurich.[18]

2.10 One obvious difference between the United States and these other jurisdictions is that, in the United States, each party to the proceedings bears his or her own costs, and does not have to pay the other party's legal costs, except where the litigation is vexatious or an abuse of process. This rule, coupled with the availability of contingency fees, means that it costs the plaintiff almost nothing to bring a civil claim.

Trial by jury

2.11 In the United States, the right to jury trial in a civil case is constitutionally protected. It is a unique feature of the American civil justice system that a plaintiff is entitled to a jury trial in almost any case involving personal injuries. The jury decides not only the issue of liability, but also that of damages. Since juries generally have no technical training or prior litigation experience, they may be subject to influence by attorneys in ways that judges are not.[19]

Punitive damages

2.12 Punitive damages are also within the jury's discretion in many states, and the readiness of American courts and juries to award punitive damages is another reason for the high awards in the United States.[20] The problem has been compounded by the extensive publicity given to the initial awards and the relative under-reporting of those cases where the quantum has

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17 See para 1.9 above.

18 See Australian Law Reform Commission, *Costs shifting – who pays for litigation* (1995, Report No 75), at Appendix C.

19 D Debusschere & J L Hom, "*United States*" in D Campbell (ed), *International Product Liability* (1993), at 564. HKLRC, *Report on Civil Liability for Unsafe Products* (1998), para 6.10.

20 Ontario Law Reform Commission, *Report on Products Liability* (1979), at 75. HKLRC, cited above.

been reduced on appeal. This would tend to affect jury sensibilities and fuel the expectations of would-be claimants and their lawyers.[21]

Specialised plaintiff bar

2.13 There is a division between lawyers who specialise in acting for plaintiffs on a contingency fee basis and defence lawyers who charge hourly rates.[22] The lucrative nature of the contingency fee system for the more aggressive specialist plaintiffs' bar encourages the filing of speculative actions.[23]

Precedents not binding

2.14 The American courts openly embrace a high level of judicial law-making and a flexible approach to precedents.[24] To American judges, predictability and certainty in the law seem to count for less than perceived justice in the individual case.[25]

Discovery

2.15 In the United States, pursuant to Rule 26(b)(1) of the Federal Rules of Civil Procedure,[26] subject to some limitations, parties may obtain discovery regarding any matter, not privileged, that is relevant to the claim or defence of any party, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. For good cause, the court may order discovery of any matter relevant to the subject matter involved in the action. Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence. This approach opens the door to "fishing expeditions" to uncover new avenues of liability. It has been commented that the American process of discovery is such that it is possible for an action to be commenced without any substantive evidence, and the process of discovery can be used to find both evidence and defendant.[27]

2.16 In Hong Kong, by contrast, the extent of the right of discovery is more restrictive, especially in respect of discovery against those who are not parties to the proceedings. By virtue of Order 24 rule 7A of the Rules of the High Court (Cap 4A), which applies only to personal injury cases, the application has to be supported by an affidavit which must specify or describe

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21 Stapleton, *Product Liability* (1993), at 78. HKLRC, cited above.

22 Australian Law Reform Commission, *Product Liability* (1989, Report No 51), at 10. HKLRC, cited above.

23 HKLRC, cited above.

24 Stapleton, cited above, at 75 and 79. HKLRC, cited above.

25 As above, at 71. HKLRC, cited above.

26 Including amendments effective 1 December 2000.

27 Australian Law Reform Commission, cited above, at 10. HKLRC, cited above.

the documents in relation to which the order is sought and show that the documents are relevant to an issue arising in the proceedings. Discovery of documents or facts against non-parties is not normally available.[28]

Absence of legal aid

2.17 The extensive legal aid system for civil claims available in many jurisdictions is not available in the United States. In the absence of such a system, mechanisms such as contingency fees and costs not following the event facilitate access to justice.

Class actions

2.18 The United States' civil procedure caters for class actions which allow a large group of plaintiffs to pursue a common claim against one or more defendants. Class actions are distinct from typical joinder situations in both the number of litigants involved and in the manner in which most class members participate in the case.[29] Rule 23 of the Federal Rules of Civil Procedure contemplates that the class of litigants will be represented both by counsel and by "class representatives" (ie active members of the class who make many decisions for the entire class).[30]

2.19 The requirements of a class action are set out in Rule 23(a):

> *"One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class."*

Non-specific pleadings

2.20 Rule 8 of the Federal Rules of Civil Procedure requires that a pleading which sets forth a claim for relief shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, (2) a short and plain statement of claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks.

2.21 In Hong Kong, by contrast, pleadings have to be specific. Order 18 rule 12 of the Rules of the High Court (Cap 4A) requires that every pleading

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28 W S Clarke, *Hong Kong Civil Court Practice* (2000, Butterworths), at 175.

29 Baicker-McKee, *Federal Rules of Civil Procedure* (2001, West Group), at 386.

30 As above.

must contain the necessary particulars of any claim, defence or other matter pleaded.[31]

Conclusion

2.22 It seems, therefore, that the way in which contingency fees operate in the American civil litigation system flows from the interplay of a number of factors. What may be considered to be the undesirable elements of the US system, such as the high level of litigation and the extreme level of awards, go wider than contingency fees and have their roots in some fundamental features of the US civil justice system. It is not possible, for instance, to attribute the high level of litigation to contingency fees or any one factor alone. In fact, when Aranson criticised the American percentage contingency fee system,[32] he made it clear that he believed "*some form of contingency fee system is essential to facilitate access to the justice system in the United States.*" He found England's conditional fee system an attractive model which could maintain the present advantages and mitigate the disadvantages of the percentage contingency fee system. The next two chapters will examine the development of conditional fees in England and the problems encountered.

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[31] See also *Aktieselskabet Dansk Skibsfinansiering v Wheelock Marden* [1994] 2 HKC 264 (CA), at 269E-270E, *per* Bokhary JA, which set out the general requirement of pleadings.

[32] See para 2.7 above.

Chapter 3

Legislative changes in England concerning conditional fees

Introduction

3.1 In stark contrast to the United States, which lifted the ban on contingency fees in the nineteenth century, England until 1995 retained the centuries-old ban against contingency fee arrangements. Zander commented in 2002 that the "*English system for the funding of civil litigation is in the throes of a revolution*".[1] David Lammy, England's Minister for Civil Justice, in 2004 described the preceding few years as having been ones of "*unhelpful turbulence*".[2] We set out in this chapter the numerous legislative changes in England relating to conditional fees. The situation remains in a state of development.

Maintenance and champerty

3.2 Until recently, any form of contingency fee arrangement was not enforceable at common law in England and Wales. The rule has its origins in the ancient common law crime and tort of "maintenance", which is the giving of assistance, encouragement or support to litigation by a person who has no legitimate interest in the litigation, nor any motive recognised by the court as justifying the interference.[3] "Champerty" is an aggravated form of maintenance, in which the maintainer supports the litigation in consideration of a promise to give the maintainer a share in the proceeds or subject matter of the action.[4]

3.3 The law in this area developed as a response to perceived abuse of the judicial process in medieval England, whereby interference in litigation by powerful nobles and officials was a tactic used to oppress individuals or protect the interests of the rulers.[5] Champerty was especially feared, because the champertor's financial stake in the court action provided strong temptation to suborn justices and witnesses, and to pursue worthless claims

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1 M Zander, "Will the Revolution in the Funding of Civil Litigation in England Eventually Lead to Contingency Fees?" (Winter 2002), 52 DePaul L Rev 259.

2 UK Department for Constitutional Affairs, *Making simple CFAs a reality* (29 June 2004), at 8.

3 Lord Chancellor's Department, *Contingency Fees* (1989 : Cmnd 571), at 3.

4 As above.

5 New South Wales Law Reform Commission, *Barratry, Maintenance and Champerty*, (1994) Discussion Paper 36, at para 2.9.

which a defendant may have lacked resources to withstand.[6] Blackstone's Commentaries record that "*This is an offence against public justice, as it keeps alive strife and contention, and perverts the remedial process of law into an engine of oppression.*"[7]

3.4 Champerty and maintenance were deemed unlawful for fear of encouraging "mischievous" litigation. In 1895, Lord Esher, MR observed that:

> *"The doctrine of maintenance … does not appear to me to be founded so much on general principles of right and wrong or of natural justice as on considerations of public policy. I do not know that, apart from any specific law on the subject, there would necessarily be anything wrong in assisting another man in his litigation. But it seems to have been thought that litigation might be increased in a way that would be mischievous to the public interest if it could be encouraged and assisted by persons who would not be responsible for the consequences of it, when unsuccessful."*[8]

3.5 The public policy considerations which shaped the doctrine of maintenance in medieval times changed with changing social conditions and the courts recognised that the class of persons and organisations deemed to have justifiable interests in others' proceedings had to be broadened. Lord Denning MR has commented that:

> *"Most of the actions in our courts are supported by some association or other, or by the state itself. Comparatively few litigants bring suits, or defend them, at their own expense. Most claims by workmen against their employers are paid for by a trade union. Most defences of motorists are paid for by insurance companies. This is perfectly justifiable and is accepted by everyone as lawful, provided always that the one who supports the litigation, if it fails, pays the costs of the other side."*[9]

Criminal Law Act 1967

3.6 In modern times, maintenance and champerty as crimes and torts fell into disuse and they were duly abolished in England in 1967, shortly after the judgment in *Hill v Archibald.*[10] Abolition followed a report by the Law

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6 *Giles v Thompson* [1994] 1 AC 142, at 153, *per* Lord Mustill. Cited by New South Wales Law Reform Commission above.

7 *Blackstone's Commentaries on the Law of England* (1897), s 12.

8 *Alabaster v Harness* [1895] 1 QB 339, at 342. Cited by New South Wales Law Reform Commission, cited above, at para 2.8.

9 *Hill v Archbold* [1968] 1 QB 686, at 694-695. Cited by New South Wales Law Reform Commission, cited above, at para 2.10.

10 As above.

Commission[11] which found that "*maintenance and champerty are a dead letter in our law*" and:

> *"… the great bulk of litigation which engages our courts is maintained from sources of others, including the state, who have no direct interest in its outcome, but who are regarded by society as being fully justified in maintaining it."*[12]

The report instanced as maintainers of litigation, trade unions, trading associations, third party liability insurance and the state funded legal aid scheme. The report recommended that criminal and tortious liability for champerty and maintenance should be abolished and this was duly implemented by the Criminal Law Act 1967.

3.7 The Criminal Law Act 1967, however, included a provision that the abolition of criminal and tortious liability for champerty and maintenance "*shall not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal.*"[13] This section was in response to the Law Commission's recommendation that "*champertous agreements (including contingency fee arrangements between solicitor and client) should for the present, continue to remain unlawful as contrary to public policy.*"[14]

3.8 Hence, after the Criminal Law Act 1967, contingency fee arrangements were still regarded as contrary to public policy and unlawful.[15] Lord Denning's dictum in *Wallersteiner v Moir (No 2)*[16] reflected the attitude of the courts at that time:[17]

> *"English law has never sanctioned an agreement by which a lawyer is remunerated on the basis of a 'contingency fee', that is that he gets paid the fee if he wins, but not if he loses. Such an agreement was illegal on the ground that it was the offence of champerty."*[18]

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11 *Proposals for Reform of the Law Relating to Maintenance and Champerty* (1966), Law Com No 7.

12 As above, at paras 7, 15.

13 Section 14(2).

14 The English Law Commission, *Proposals for Reform of the Law Relating to Maintenance and Champerty* (1966), Law Com No 7, at para 20.

15 M Zander, cited above, at 2.

16 [1975] QB 373.

17 In an earlier case, *Re Trepca Mines Ltd* [1962] 3 All ER 351, Lord Denning explained the underlying public policy: *"The reason why the common law condemns champerty is because of the abuses to which it may give rise. The common law fears that the champertous maintainer might be tempted, for his own personal gain to inflame the damages, to suppress evidence, or even to suborn witnesses."*

18 [1975] QB 373 at 393.

Solicitors Act 1974

3.9 Agreements to act on a contingency basis are also restricted by section 59 of the Solicitors Act 1974. Subject to the recent changes in the law described below, they are proscribed in respect of proceedings in England and Wales by rule 8 of the Solicitors Practice Rules 1988, which provides that:

> *"A solicitor who is retained or employed to prosecute any action, suit or other contentious proceeding shall not enter into any arrangement to receive a contingency fee in respect of that proceeding."*[19]

A contingency fee is defined in the Solicitors Practice Rules as:

> *"… any sum (whether fixed or calculated either as a percentage of the proceeds or otherwise howsoever) payable only in the event of success in the prosecution of any action, suit or other contentious proceeding."*[20]

The rules have effectively prohibited any fee arrangements dependent on the outcome of any contentious proceeding.[21]

The Royal Commission on Legal Services 1979[22]

3.10 The concept of contingency fees was considered by the Royal Commission on Legal Services in 1979 which rejected the idea on the ground that it would foster malpractices:

> *"The fact that the lawyer has a direct personal interest in the outcome of the case may lead to undesirable practices including the construction of evidence, the improper coaching of witnesses, the use of professionally partisan expert witnesses, especially medical witnesses, improper examination and cross-examination, groundless legal arguments, designed to lead the courts into error and competitive touting."*[23]

Green Paper on Contingency Fees 1989[24]

3.11 The 1989 Green Paper on *Contingency Fees* (the 1989 Green Paper) was devoted wholly to the subject of contingency fee arrangements. Perhaps because of the controversial nature of the topic, the 1989 Green

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19 Solicitors Practice Rules 1988 ("SPR") rule 8(1).

20 Solicitors Practice Rules 1988 ("SPR") rule 18(2)(c).

21 M Zander, cited above.

22 The Benson Commission, (1979, Cmnd 7648).

23 Para 16.4.

24 Lord Chancellor's Department, Cmnd 571, cited above. Prior to this in 1988, a Report by the Review Body on Civil Justice (Cmnd 394, at paras 384-389) encouraged the Lord Chancellor to review the matter.

Paper did not put forward firm recommendations. It merely said that:

> *"Examination of the arguments and issues arising in the debate on the introduction of contingency fees suggests that it is time to consider at least some relaxation of existing restrictions."*[25]

Risk of conflict of interest

3.12 The 1989 Green Paper examined the various arguments for and against the introduction of contingency fees, and found that there was no real basis to fears that the lawyer acting on a contingency basis would engage in malpractices such as encouraging the client to accept an unnecessarily low settlement, engaging in unmeritorious cases with a high nuisance value realising that the opponent would settle, coaching witnesses, or withholding inconvenient evidence.[26]

3.13 The 1989 Green Paper stated that any malpractices ought to be capable of control through stringent codes of practice to which both branches of the profession were subject. The Green Paper pointed out that judges also have the power to penalise solicitors personally in costs for any improper act or omission in the conduct of litigation.[27]

The United States experience

3.14 The 1989 Green Paper also dealt with the argument that the existence of contingency fees in the United States encouraged juries in civil cases to award excessively high damages to successful plaintiffs, so that even after the lawyer has taken his percentage (which may be as high as 50%), the balance would still be sufficient to compensate the plaintiff for his losses. Critics of contingency fees further argued that contingency fees would encourage the pursuit of low merit cases for nuisance value against large companies and Government bodies. Insurance premiums would be driven up and the increased business costs would have to be borne ultimately by the consumer.[28]

3.15 In this regard, the 1989 Green Paper said that any form of contingency fee, if introduced into England and Wales, would need to operate within the current system for awarding damages. As the amount of damages would be decided by the judge, not the jury, according to well-established guidelines, the introduction of contingency fees would have little bearing on the sums awarded; just as the application of the statutory charge to damages recovered by a legally aided litigant would not result in an increased level of damages. In any case, if there were a need, a rule could be introduced so that the contingency arrangements should not be revealed to the judge until

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25 Para 5.1.
26 Para 3.2.
27 Para 3.3.
28 Paras 3.5-3.6.

after judgment had been given, in the same way as a payment into court could not be revealed to the judge until the case had concluded.[29]

3.16 The 1989 Green Paper also pointed out that the costs indemnity rule in England and Wales would continue to be an effective deterrent against frivolous actions even if contingency fees were introduced.[30]

Access to justice

3.17 The 1989 Green Paper stated that the main advantage of contingency fees was that "small" plaintiffs would have the opportunity of bringing their claims to court. "Small" in this context meant those individuals and organisations who did not qualify for legal aid but nevertheless had insufficient means to support the full cost of expensive litigation. Further, legal aid was not available in respect of certain types of proceeding. Contingency fees might be useful to sections of the population whose means took them above the legal aid eligibility limits.[31]

Allowing the consumer to choose

3.18 The Green Paper pointed out that consumers would have the choice between contingency or conventional fee arrangements. Solicitors would then have the incentive to operate more efficiently and to expedite the proceedings.[32]

Options set out in the 1989 Green Paper

3.19 Having examined the arguments for and against contingency fees, the 1989 Green Paper considered several possible options:

(i) Adopt the speculative basis, as was already possible in Scotland. A solicitor would be able to recover only his normal taxed costs in the event of success, and nothing if the proceedings were not successful. If it were necessary to instruct counsel, this would again be on a speculative basis, with the counsel's clerk being informed of the basis before the brief was accepted. This basis, unsurprisingly, had not been widely adopted in Scotland, and information received from the Faculty of Advocates indicated that only about 1% of the Faculty's caseload had been conducted on a speculative basis.[33]

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29 Para 3.8.
30 Para 3.9.
31 Para 3.12.
32 Para 3.13.
33 Paras 4.1 and 4.3.

(ii) The second option modified the speculative basis by adding a percentage to the taxed costs in the event of success. The extra percentage ("the uplift"), could be fixed by reference to the amount of taxed costs, rather than by reference to the amount of damages or property recovered. In this way, the lawyer would not have a direct financial interest in the level of damages recovered.[34] Fees on this basis would eventually be called conditional fees.

(iii) The third option, termed a restricted contingency basis, was to allow contingency fees in the American sense but to restrict the percentage of the damages that could be taken by the lawyers, depending on the stage the proceedings had reached.[35]

(iv) The fourth option, an unrestricted contingency basis, would be to allow contingency fees as a percentage of the damages without any upper limit. The Green Paper considered that this option would not be in the public interest due to the unequal bargaining power of the lawyer and his client.

Responses to the 1989 Green Paper

3.20 The Bar was strongly opposed to any change, primarily on ethical grounds.[36] The Law Society was also opposed to contingency fees on ethical grounds. However, it supported the second option of the speculative fee plus a percentage uplift of costs by way of a success fee.[37]

3.21 Six months after the publication of the 1989 Green Paper, the White Paper on *Legal Services: A Framework For The Future*[38] was issued, which subsequently resulted in the 1990 Act.

Courts and Legal Services Act 1990

3.22 Section 58(3) of the Courts and Legal Services Act 1990 gave effect to the White Paper by legitimising conditional fee agreements, so that a conditional fee agreement "*shall not be unenforceable by reason only of its being a conditional fee agreement*".[39] The Act empowered the Lord

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34 Paras 4.4-4.5.

35 Para 4.6.

36 General Council of the Bar, *Quality of Justice : The Bar's Response,* (1989), at 258-64. Cited by M Zander, cited above, at note 31.

37 Law Society, *Striking the Balance,* The Final Response of the Council of the Law Society on the Green Paper (1989). Cited by M Zander, cited above, at note 32.

38 Cm 749 (1989).

39 According to M Zander, cited above, at 4, this provision has the effect of preserving the solicitor's rights against his client and to preserve the client's right to recover costs from the other side despite the fact that the agreement was still maintenance and champertous. If a conditional fee agreement remains maintenance, the lawyers could be liable to the successful party for his costs if his client is uninsured against the loss and cannot pay the winner's costs. According to Michael J Cook, *Cook on Costs* (2002), at 472, in 1999 Lord Spens's action

Chancellor, through subordinate legislation, after consultation with the designated judges and the profession, to prescribe the types of cases for which conditional fee agreements would be enforceable and to determine the permissible level of uplift fee on success.

Conditional Fee Agreements Regulations 1995[40] and Conditional Fee Agreements Order 1995[41]

3.23 Some five years were needed to fine-tune the new conditional fee arrangements, and the Conditional Fee Agreements Regulations and Conditional Fee Agreements Order did not come into force until 5 July 1995. The main features of conditional fee agreements as at 1995 were:

- Conditional fee agreements were allowed only in three types of proceedings. These were insolvency and personal injury matters, as well as proceedings brought before the European Commission of Human Rights and the European Court of Human Rights.

- Solicitors and barristers working under conditional fee agreements were entitled only to such success fees as were agreed, and normal fees either as agreed or allowed on taxation.

- The maximum allowable success fee was set at 100% of the solicitor's normal costs.

- Solicitors and barristers were not allowed to claim a percentage of the damages awarded.

- Solicitors were expected to fund all necessary disbursements themselves as a business overhead. Such disbursements could include:

  (a) the cost of obtaining insurance for the client against the risk of his losing and having to pay costs to the other side,
  (b) the court fees,
  (c) the cost of obtaining expert reports,
  (d) the payment of counsel's fees,[42] unless counsel was also willing to act under a conditional fee agreement.

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against the Bank of England collapsed as he could not afford the premium of the £100,000 for ATE insurance to cover the anticipated costs of £750,000. His solicitors refused to continue for fear that they might be held liable as maintainers of the litigation.

40 (SI 1995/1675).

41 (SI 1995/1674).

42 In England & Wales, it is possible to have a time-cost barrister working with a conditional fee solicitor in the same case. Where the barrister has a conditional fee agreement, if the client wins, the barrister's fee is the solicitor's disbursement which can be recovered from the opponent. The client must pay the barrister's uplift fee shown in the separate conditional fee agreement the solicitor makes with the barrister. The solicitor will discuss the barrister's uplift fee with the client before instructing the barrister. If the client loses, he pays nothing. In

- Disbursements would not be eligible for any uplift.

- A losing party who was liable to pay costs would not have to pay any extra because his opponent had a conditional fee agreement, under which his solicitors and/or counsel's fees were subject to an uplift. In other words, the entire uplift or success fee would have to be funded by the client from any damages recovered.

- The Law Society recommended at that time that solicitors' uplifts be capped when they reach 25% of the damages recovered and the Bar Council recommended that counsel's uplifts be capped when they reach 10%.

3.24 The uplift by way of success fees that lawyers could charge was up to 100% of the fees.[43] This was the subject of fierce political debate. Zander has pointed out that the success fee is a percentage of the solicitor's base costs, excluding disbursements; and whilst base costs cover overheads as well as profit, the success fee is all profit.[44] On the other hand, the extra profits might be needed to cover the cases that were lost. It was reported that two firms acting on conditional fee agreements against tobacco companies had abandoned the case, and the cost to one of the firms was some £2.5 million.[45]

3.25 The 1995 Regulations list out the elements that must be included in a conditional fee agreement if it is to be enforceable. Each agreement must describe:

(a) the particular proceedings or parts of them to which it relates, including whether it relates to any counterclaim, appeal or proceedings to enforce a judgment or order;

(b) the circumstances in which the legal representative's fees and expenses or part of them are payable;

(c) what, if any, payment is due (i) on partial failure of the specified circumstances to occur (i.e. if the case is lost); (ii) irrespective of

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cases where the barrister does not have a conditional fee agreement, if the client loses and has not been paying the barrister's fees on account, the solicitor is liable to pay them. Because of this, the solicitor adds an extra success fee if the client wins. This extra success fee is not added if the client has been paying the barrister's fees on account. If the client wins, he is liable to pay the barrister's fees.

[43] At first the Lord Chancellor's Department's Consultation Paper suggested that the success fee should be restricted to 10% of normal costs. The Law Society argued that raising the success fee to 100 per cent would enable a lawyer to break even if half of the cases taken on a conditional fee basis were successful. This argument was considered implausible by M Zander, given that conditional fees would be used principally in personal injury cases which usually result in settlement plus a payment of agreed costs.

[44] M Zander, cited above, at 4.

[45] The Times (27 February, 1999) and Law Society Gazette (3 March 1999). Cited by M Zander, cited above.

the specified circumstances occurring (ie outlays/disbursements); and (iii) on determination of the agreement for any reason; and

(d) the amount or amounts payable in accordance with (b) or (c), above, or the method to be used in calculating the amount or amounts payable, and in particular whether the amount payable is limited by reference to the amount of any damages that may be recovered on behalf of the client (that is, a "cap").

3.26 The 1995 Regulations also state that the contract must confirm that the solicitor has discussed specific points with the client immediately before signing. These are:

(a) whether the client might be entitled to legal aid in respect of the proceedings to which the agreement relates, the conditions on which legal aid is available and the application of those conditions to the client in respect of the contemplated proceedings;

(b) the circumstances in which the client may be liable to pay the fees and expenses of the legal representative in accordance with the agreement;

(c) the circumstances in which the client may be liable to pay the costs of any other party to the proceedings; and

(d) the circumstances in which the client may seek taxation of the fees and expenses of the legal representative and the procedure for so doing.

3.27 The obvious danger area is in the calculation of the success fee and any cap on fees. In fact, the Regulations do not specifically require the lawyer to fix the percentage of success fee by reference to the risk of losing the case. Evans suggested that the recommended formula for calculating the success fee should be: (F ÷ S) × 100 = SF, where F = prospects for failure, S = prospects of success, and SF = the success fee. So, a case with a 75% prospect of success would attract a success fee of (25 ÷ 75) x 100 = 33.33%.[46] The computation is obviously subjective and clients would not be in a position to evaluate the solicitor's assessment of the prospects of success.

After-the-event insurance

3.28 Given the costs indemnity rule, a conditional fee agreement alone would not protect the client against payment of the opponent's legal costs in the event of unsuccessful proceedings. The introduction of conditional fee agreements had led to the development of "after-the-event

[46] John C Evans, England's New Conditional Fee Agreements : How will they change litigation? Defence Counsel Journal July 1996 (63 Def Couns J 376).

insurance" (ATE insurance),[47] which typically covers the claimant against the opponent's legal fees and disbursements and the claimant's own disbursements.

3.29 In 1995, Lexington Insurance Co, for example, offered a service called Accident Line Protect to members of the Law Society. This was intended as a quality control provision and negated the need to screen every applicant on a routine basis.[48] A one-off premium of £85 would buy £100,000 of coverage in 1995 in respect of the other side's costs and the client's expert fees and certain disbursements. By August 2004, the premium for the same coverage for a road traffic accident case was £375. The premiums for occupational disease claims and other types of claims were £1,175 and £815 respectively.[49]

3.30 The following types of cases are automatically covered by Accident Line Protect:

- Plaintiffs' personal injury cases arising anywhere in the European Union, so long as proceedings are brought in England and Wales. Personal injury is defined as "*any disease and any impairment of a person's physical or mental condition for which damages may be claimed.*"

- Mixed cases in which a personal injury claim is being run in conjunction with another related claim. Examples would include the aftermath of a motor accident where someone is seeking compensation for both physical injuries and property damage to the vehicle, or a construction dust nuisance allegation where adverse health consequences are alleged to have followed the exposure. So long as there is a personal injury element to the action, all elements of the case will be covered by the insurance.

- Actions against other solicitors for the alleged negligent handling of a personal injury case.[50]

3.31 Some types of cases have to be referred to the insurer for prior approval:

- Multi-party actions involving ten or more claims;

- Claims for psychiatric injury "*where there is no recognised cause of action in English law*". This means claims for categories of psychiatric illness that have not been recognised previously as

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47 As opposed to before-the-event Insurance (BTE) which covers a range of legal problems as "add ons" to house insurance or motoring policies. These policies usually cover lawyers' fees, court fees, costs of witnesses and experts plus costs of the opponent if the insured is ordered to pay them. See M Zander, cited above.

48 John C Evans, cited above.

49 Litigation Funding, August 2004 Issue 32 at 10.

50 John C Evans, cited above.

compensatable by the courts and where the case will be breaking new ground;

- Where a personal injury claimant is seeking additional damages for further injuries allegedly caused by the negligent medical treatment of the claimant's original injury;

- An appeal; and

- Where a new firm takes over the handling of a client's case in which the original solicitor was acting under a conditional fee agreement.[51]

3.32 Certain types of cases are expressly excluded from coverage. They are:

- Medical negligence;

- Pharmaceutical, drug or tobacco-related claims;

- Accidents that occur outside the European Union;

- Proceedings outside the jurisdiction of the courts of England and Wales;

- Counterclaims, whether brought by defendants or defended by plaintiffs; and

- Small claims court cases.[52]

3.33 Various policies were available, but typically, policies will pay the other side's costs, the client's expert fees and other disbursements on any of the following events:

- Judgment in favour of the defendant;

- Failure to beat a payment into court under certain limited circumstances;

- Service of a notice of discontinuance, with the insurer's prior consent, requiring payment of the defendant's costs;

- The making of no order as to costs, leaving the client to pay his own disbursements; and

- A successful appeal by the defendant.[53]

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51 As above.
52 As above.
53 As above.

3.34 Accident Line Protect does not, however, cover the plaintiff's firm's costs, agents' fees, barrister's fees, costs and disbursements incurred before policy inception; and any disbursements incurred in circumstances where the claim is abandoned before proceedings are issued.[54]

Counsel's fees

3.35 In a conditional fee situation, there are three possible arrangements with regard to counsel's fees. First, the solicitor and counsel can each enter into separate conditional fee agreements with the client; second, the solicitor can enter into a conditional fee agreement with the client but counsel's fees are incurred by the conventional method; and third, the counsel can enter into a conditional fee agreement with the client but the solicitor's fees are incurred in the conventional way.

3.36 The Law Society of England and Wales recommends that the total of the solicitor's and counsel's success fees combined should not exceed 25% of the damages recoverable.[55] However, this recommendation is only persuasive. The "cab rank" rule does not apply to conditional fee agreements and counsel cannot be compelled to accept instructions on a conditional fee basis.[56] Chambers as a whole, or certain counsel within chambers, may agree to do conditional fee work, and may agree to accept returns in conditional fee agreement cases among themselves so that suitable replacement counsel can be found within the same chambers to accept the case on a conditional fee agreement basis.[57]

Evaluation of conditional fee agreements in 1997

3.37 The Lord Chancellor's Advisory Committee on Legal Education and Conduct commissioned the Policy Studies Institute (the PSI) to carry out research into the operation of conditional fees in 1997. The PSI Report[58] found that, within 15 months of their introduction, conditional fee agreements had become an established method of payment for personal injury litigation.[59] Another source[60] also found that the conditional fee arrangement was "*generally judged a success*".

3.38 The PSI Report found that in three-quarters of the cases surveyed, the main reason for taking out a conditional fee agreement was that the client was ineligible for legal aid and could not afford to pay out of his own

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54 As above.
55 Greenslade on Costs, at B-038.
56 Greenslade, cited above, at B-039.
57 As above.
58 Written by Stella Yarrow. PSI is an independent research organisation undertaking studies of economic, industrial and social policy and the workings of political institutions.
59 Yarrow, at Chapter 2.
60 B Main & A Peacock, *What price civil justice?* (1998), University of Edinburgh.

resources. The indications were that conditional fees were indeed widening access to justice.[61]

3.39 In relation to earlier concerns that the 100% maximum permissible uplift or success fee would become the norm, the PSI Report found that the average uplift was 43%, well below the maximum figure. In three-quarters of the cases surveyed, the uplift was under 50%. The survey also showed that the average uplift increased as the chances of success decreased. Road traffic accidents, for example, had the lowest average uplift of 33%, with the most common uplift in this category falling within the 1-20% range. The PSI Report, however, found that there were a number of cases where the uplift and prospect of success did not seem to bear any correlation. It pointed out that taxation was available as a protection for clients against excessive uplifts, and so was the voluntary cap of 25% of the damages recommended by the Law Society.[62]

3.40 As for ATE insurance, this had been taken out in 99% of cases, and Accident Line Protect insurance was used in almost all cases. Accident Line Protect dominated the market due to the significant competitive advantage of its low premium.[63] Solicitors registered with Accident Line Protect were required to offer only this policy in all eligible cases in order to prevent only the weak cases being insured. Accident Line Protect was offered only to solicitors on the Personal Injury Panel. This restriction could potentially deter other solicitors from entering the conditional fee market, though it encouraged clients to use solicitors with expertise in the field.[64]

3.41 As for the concern that conditional fees would lead to a vast increase in spurious litigation, the PSI Report found that it had not materialised. The Report pointed out that there was little incentive for lawyers to pursue litigation under a conditional fee agreement which had little prospect of success. The survey found that solicitors were choosing to take only a tiny number of cases with a less than 50% chance of success. Of the cases surveyed, only one per cent fell into this category, with the vast majority – 82% – being estimated as having a good or very good chance of success.[65] There was also no real evidence of "ambulance chasing" or improper marketing by solicitors. However, the widening of solicitors' advertising rules, coupled with the raised profile for this type of case, and entry into the market of commercial organisations, such as Accident Line Protect insurance, combined to bring advertisements for claims work to television and radio for the first time.

Further reforms 1998 – 2000

3.42 After an encouraging start, the conditional fees system underwent further reforms from 1998 to 2000. Originally, conditional fee

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61 Yarrow, at Chapter 3.
62 Yarrow, at Chapter 4.
63 However, by 1999, the premium rose to over £3,000 for the same policy.
64 Yarrow, at Chapter 5.
65 As above.

agreements were restricted to personal injury, insolvency and human rights cases. In October 1997, the Lord Chancellor, Lord Irvine:

> *"… caused consternation in the legal world by announcing that legal aid for the indigent would be abolished for all damages and money claims on the ground that they could now be financed through conditional fee agreements."*[66]

Consultation Paper on "Access to Justice with Conditional Fees" 1998[67]

3.43 The 1998 Consultation Paper stated that by the end of 1997, after conditional fees had been made available for some 30 months, around 34,000 policies had been issued, with their use increasing as lawyers developed their expertise in this area.[68] The Government could see no good reason to continue to prohibit the wider use of conditional fees, and proposed to allow conditional fee agreements to be entered into in any proceedings other than those categories proscribed by statute (ie family and criminal cases).[69]

3.44 The 1998 Consultation Paper further stated that the Government was minded to amend the law to allow the uplift or success fees and the insurance premium to be recoverable from the losing party.[70] The reason given was that both types of costs were incurred directly because the loser had put the successful party to the cost of taking proceedings, and they should be recoverable in the same way as other costs.

3.45 The insurance industry was strongly against the idea of making insurance premiums and success fees recoverable. If success fees were recoverable, solicitors would have an added incentive to inflate the success fee. If insurance premiums were made recoverable, then defendants with stronger cases would end up paying higher amounts since the success fee charged by the other side's solicitors would be higher for a risky case. The Bar and the Law Society agreed with the proposal to make insurance premiums and success fees recoverable.

Conditional Fee Agreements Order 1998

3.46 In 1998, a new Conditional Fee Agreements Order[71] revoked the 1995 Order. Conditional fee agreements were to be permissible in all civil proceedings other than family and criminal cases. Article 4 of the new Order retained 100% as the maximum permitted percentage increase.

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66 M Zander, cited above.
67 Issued by the Lord Chancellor's Department, March 1998.
68 Para 2.5.
69 Paras 2.6-2.7.
70 Para 2.17.
71 (SI 1998/1860).

Access to Justice Act 1999

3.47 The Access to Justice Act 1999 brought about further changes as follows:

(a) A new Legal Services Commission was created to replace the Legal Aid Board, with power to determine which types of litigation should qualify for public funding and, from 1 April 2000, what used to be described as legal aid was no longer to be available for personal injury cases, except clinical negligence cases.

(b) The use of conditional fee agreements was extended to cover all civil cases, including family work relating solely to financial matters and property. Family work involving issues concerning the welfare of children and criminal work remained outside the scope of the conditional fee regime.[72] Proceedings other than court proceedings, such as arbitrations, were also covered.

(c) The successful litigant can recover from the losing litigant the premium payable for an insurance policy against the risk of having to pay the opponent's costs.[73]

(d) The successful litigant can also recover from the losing litigant the success fee or uplift agreed between the successful litigant and his own lawyer,[74] subject to taxing down by the Court.

3.48 According to the Explanatory Notes to the 1999 Act, the objective of the new provisions was to:

- *"ensure that the compensation awarded to a successful party is not eroded by any uplift or premium – the party in the wrong will bear the full burden of costs;*

- *make conditional fees more attractive, in particular to defendants and to plaintiffs seeking non-monetary redress – these litigants can rarely use conditional fees now, because they cannot rely on the prospect of recovering damages to meet the cost of the uplift and premium;*

- *discourage weak cases and encourage settlements; and*

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72 Section 27(1).

73 Section 29. *"Where in any proceedings a costs order is made in favour of any party who has taken out an insurance policy against the risk of incurring a liability in those proceedings, the cost payable to him may, subject in the case of court proceedings to rules of court, include costs in respect of the premium of the policy."*

74 Section 58A(6) of the Courts and Legal Services Act 1990, as substituted by section 27 of the Access to Justice Act 1999, provides that: *"A costs order made in any proceedings may, subject in the case of court proceedings to rules of court, include provision requiring the payment of any fees payable under a conditional fee agreement which provides for a success fee."*

- *provide a mechanism for regulating the uplifts that solicitors charge – in future unsuccessful litigants will be able to challenge unreasonably high uplifts when the court comes to assess costs*."[75]

3.49 In one sense, the changes concerning the recoverability of the insurance premium and the success fee simply strengthened the ordinary costs rule that costs follow the event and the loser should pay. In another sense, they could be seen as asking the loser to pay twice.[76] They have certainly been the source of much controversy and satellite litigation.

3.50 The House of Lords has made some observations on the rule that the successful litigant can recover both the insurance premium and the solicitors' success fee from the opponent. In *Callery v Gray* (Nos 1 and 2),[77] which will be discussed further later in Chapter 4, Lord Nicholls of Birkenhead gave his views as follows:

> *"… The underlying problem, it was said, is that claimants now operate in a costs-free and risk-free zone.*
>
> *… By entering into a conditional fee agreement at the outset, a claimant achieves the position that his solicitor's charges will never be payable by him or at his expense. If his claim is successful the fees, including the amount of the uplift, will be payable by the defendant's liability insurers. If his claim is unsuccessful, nothing will be due from him to his solicitor under the agreement. Likewise with the premium payable for after the event insurance: if the claim is successful, the premium will be payable by the other side's liability insurers. If the claim is unsuccessful, nothing will be payable by the claimant when, as frequently happens, the policy provides that no premium will be payable in that event.*
>
> *The consequence, it was said, of these arrangements, hugely attractive to claimants, is that claimants are entering into conditional fee agreements, and after the event insurance, at an inappropriately early stage. They have every incentive to do so, and no financial interest in doing otherwise. Moreover, in entering into conditional fee agreements and insurance arrangements they have no financial interest in keeping down their solicitors' fees or the amount of the uplift or the amount of the policy premiums. Further, they have no financial incentive to accept reasonable offers or payments into court: come what may, their solicitors' bills will be met by others. So will the other side's legal costs.*

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75 Para 3.2.

76 Richard Moorhead, *Conditional Fee Agreements, Legal Aid and Access to Justice*, University of British Columbia <http://flair.law.ubc.ca/ilac/Papers/15%20Moorhead.html>.

77 [2002] UKHL 28, 2000.

> *As a result, it was said, the new arrangements, as they are currently working, are unbalanced and unfairly prejudicial to liability insurers and the general body of motorists whose insurance policy premiums provide the money with which liability insurers meet these personal injuries claims and costs. …"*[78]

3.51 Lord Bingham of Cornhill made similar remarks on the issue and said that:

> *"… the practical result is to transfer the entire cost of funding this kind of litigation to the liability insurers of unsuccessful defendants (and defendants who settle the claims made against them) and thus, indirectly, to the wider public who pay premiums to insure themselves against liability to pay compensation for causing personal injury."*[79]

3.52 Lord Hoffmann commented that he felt considerable unease about the present state of the law concerning costs in personal injury litigation, especially in relation to small claims. Lord Hoffmann said that costs were excessive in relation to the amounts at stake (contrary to the principle of proportionality), and some elements, like ATE insurance premiums, lacked transparency, with the result that too much time, money and court resources were spent in disputes over costs. With regard to the Court of Appeal's view that matters would settle down once costs judges acquired greater experience of applying the new rules to the new system of litigation funding, Lord Hoffmann expressed doubts as to whether questions which arose in the appeals were capable of solution by traditional methods of adjudication by costs judges under guidance from the Court of Appeal. Lord Hoffmann remarked that they might require a legislative solution.[80]

3.53 As for the Law Society's proposed voluntary cap on success fees at 25% of the damages, this was removed after the success fee and insurance premium became recoverable from the loser. Zander commented that the removal of the cap would have the effect of generating "*lawyer-driven litigation*" as lawyers would have an incentive to pursue claims regardless of whether the damages claimed were small.[81]

The Conditional Fee Agreements Regulations 2000

3.54 The Conditional Fee Agreements Regulations 2000 came into force in April 2000, and the 1995 Regulations were revoked. Comprehensive contractual and client care safeguards were included in the secondary legislation.

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78 At 2005 – 2006.
79 At 2004.
80 At 2006 – 2007, para 18.
81 (2002), 52 De Paul L Rev 259, at 5.

General requirements

3.55 Regulation 2 sets out the general requirements for the contents of a conditional fee agreement, which must specify:

- the particular proceedings or parts of them to which it relates;
- the circumstances in which the legal representative's fees and expenses (or part of them) are payable;
- what payment, if any, is due:
  (a) if those circumstances only partly occur;
  (b) irrespective of whether they occur; and
  (c) on the termination of the agreement;
- the amounts which are payable in all the circumstances and cases specified or the method to be used to calculate them and, in particular, whether the amounts are limited by reference to the damages which may be recovered on behalf of the client.

Conditional fee agreements with a success fee

3.56 Regulation 3 sets out additional requirements which must be observed where a success fee is involved. The agreement must specify the reasons why the success fee has been set at the particular level and how much of the percentage increase relates to the postponement of the payment of the legal representative's fees and expenses. If the agreement relates to court proceedings:

> *"• the [agreement] must provide that where the success fee is payable (i.e. there is a win as defined in the agreement) then –*
>
> - *if the success fees are assessed and the legal representative or the client is required by the court to disclose the reasons for setting the success fee percentage at the level stated in the [agreement], he may do so;*
> - *if the success fee is assessed and any amount of it is disallowed on the ground that the level at which the success fee or percentage was set was unreasonable in view of the facts which were or should have been known to the legal representative at the time it was set, then the amount disallowed ceases to be payable under the agreement unless the court is satisfied that it should continue to be so payable; and*
> - *if there is no assessment of the success fee but the parties agree a settlement of costs under which a lower success fee is agreed to be paid, the amount payable under the [agreement] in respect of the success fee shall be reduced accordingly unless*

the court is satisfied that the full amount should continue to be payable."[82]

Information which must be given to a client before making a conditional fee agreement

3.57 Regulation 4 specifies the information which must be given orally and/or in writing to a client before making a conditional fee agreement: The client must be informed orally (and may also be informed in writing) as to:

- the circumstances in which the client may be liable to pay the costs of the legal representative in accordance with the agreement;
- the circumstances in which the client may seek assessment of the fees and expenses of the legal representative and the procedure for doing so;
- whether the legal representative considers his client's risk of incurring liability for costs in respect of the proceedings to which the agreement relates is insured against under an existing contract of insurance; and
- whether other methods of financing those costs are available and, if so, how they apply to the client and the proceedings in question.

The client must be informed both orally and in writing as to:

- whether the legal representative considers that any particular method or methods of financing any or all of those costs is appropriate and, if he considers that a contract of insurance is appropriate, or if he recommends a particular insurance contract:
  - his reasons for doing so, and
  - whether he has an interest in doing so.
- the effect of the conditional fee agreement must be explained to the client before the agreement is made.

3.58 Problems emerged from the uncertainties and satellite litigation concerning the enforceability of conditional fee agreements and the recoverability of the ATE insurance premium and success fee.[83] A losing defendant has, on many occasions, been able to overturn a conditional fee agreement on the basis that some technicality has not been complied with. This has triggered further reforms.

[82] Greenslade on Costs, at G-032.

[83] This is discussed, below, at Chapter 4.

Collective Conditional Fee Agreements Regulations 2000

3.59 The Conditional Fee Agreements Regulations 2000 relate solely to conditional fee agreements entered into on an individual basis and do not address the specific needs of the bulk provision of legal services. The legislation requires that each action must be supported by a separate conditional fee agreement, but this does not sit easily with the practical operation of the mass litigation market where legal services providers and funders, such as unions or insurers, undertake what are effectively routine cases on a mass basis. The purpose of the Collective Conditional Fee Agreements Regulations 2000 is to ensure that providers and funders of large-scale legal services are not discouraged from using conditional fee agreements by administrative hurdles.

3.60 The Lord Chancellor's Department issued a Consultation Paper on *Collective Conditional Fees* in June 2000 which resulted in the promulgation of the Collective Conditional Fee Agreements Regulations 2000.[84] Many features of the Collective Conditional Fee Agreements Regulations 2000 mirror the requirements for individual conditional fee agreements, and the main provisions are as follows:

- A collective conditional fee agreement is defined as an agreement which provides common terms for pursuing cases under the agreement, but which specifies individual success fees for those cases.

- There would be no prescription as to who could provide or use a collective conditional fee agreement, so that the public has a range of service providers to choose from.

- Where a success fee is contracted for, a separate risk assessment will be drawn up for each individual case. This must be made available to the court where costs were challenged.

- The collective agreement should contain terms that:
  - specify the conditions under which the legal representatives' fees are payable;
  - provide for the disclosure to the court of the document setting out the reasons for setting the success fee at a given level;
  - provide that any amount of the success fee disallowed on assessment as being unreasonable would cease to be payable under the agreement, unless the court orders otherwise;
  - specify that the legal representative cannot agree with the opponent to settle for a lower success fee and then seek to recover the difference from his client, unless the court orders otherwise.

[84] SI 2000/2988.

3.61 In a recent case, *Stanley Thornley v Patrick Lang*,[85] a collective conditional fee agreement between a bus drivers' union and its solicitors was challenged by the defendants, who admitted liability but objected to paying the 20% success fee agreed between the union and its solicitors. The Court of Appeal upheld the finding that the costs payable by the defendant to the claimant should include the 20% success fee.

The Civil Procedure (Amendment No 4) Rules 2003 – Fixed costs

3.62 These rules, amongst other things, introduce a scheme of fixed costs for settled road traffic accident cases (RTA cases). Other than in exceptional circumstances, only specified fixed costs, disbursements (including insurance premiums) and success fees can be recovered. The scheme applies to RTA cases occurring on or after 6 October 2003 which are settled for an amount of agreed damages not exceeding £10,000. The amount of fixed recoverable costs is the aggregate of a minimum amount of £800, plus 20% of the damages on settlements up to £5,000, plus a further 15% of damages between £5,000 and £10,000. The amount of time spent is not taken into account.

3.63 The amount of agreed damages is calculated after taking account of contributory negligence. If the case is financed by a conditional fee agreement with a success fee, the success fee is recoverable though the rate of the success fee was not fixed under the scheme. The Civil Justice Council conducted costs mediation with relevant bodies, and there is now an industry-wide agreement that an appropriate success fee for RTA cases that settle pre-trial is 12.5% of base costs. The figure for those won at trial is 100%. Currently in personal injury cases, fixed success fees only apply to employer's liability accident cases and RTA cases worth less than £15,000 that occurred after 5 October 2003. Work is under way to extend fixed success fees to disease and public liability claims run under conditional fee agreements.[86]

3.64 The ATE insurance premium is also recoverable insofar as it is reasonable. Cases such as *Callery, Halloran, Claims Direct* and *TAG* have provided some guiding principles on ATE premiums. It is hoped that a further cost mediation exercise will result in an agreement on ATE premiums as well.

3.65 In exceptional circumstances, "*the court will entertain a claim for an amount of costs … greater than the fixed costs.*"[87] The rules and practice directions are, however, silent as to what constitutes exceptional circumstances. Even if a claimant establishes that there are exceptional

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85 [2003] EWCA Civ 1484.

86 UK Dept for Constitutional Affairs, *Conditional Fees in context – Notes on the English experience,* Sept 2004.

87 Rule 45.12.

circumstances, but on assessment fails to obtain an award which is at least 20% more than the amount of the fixed costs, costs penalties will apply.[88]

3.66 According to Peysner,[89] the fixed costs scheme is susceptible to legal challenge. Originally, it was envisaged that the fixed costs scheme would be introduced together with the abolition of the costs indemnity rule. This has not materialised and, in principle, the claimant's solicitors can claim only reasonable costs. If the fixed costs are higher than reasonable costs, the difference should belong to the claimant. The "exceptional circumstances" provision discussed in the previous paragraph is only available to the claimant's solicitor who believes his entitlement is higher than the fixed costs, and there is no equivalent provision available to the payer who believes that the fixed costs are too high.

3.67 Peysner referred to the case of *Re C & H Jefferson*[90] which dealt with a similar fixed costs scheme in Northern Ireland. Caswell LCJ refused to let the payer challenge the fixed costs on the basis that they were too generous in that particular case, and said:

> *"The virtue of fixed scales is twofold. If the scales are fixed at a suitable level, proceedings in the county court can be conducted at reasonable costs, while giving a reasonable return to the practitioners who conduct them."*

Conditional Fee Agreements (Miscellaneous Amendments) Regulations 2003

3.68 These Regulations introduced a simplified version of conditional fee agreement which is often referred to as "simple CFA" or "CFA lite" and came into force on 2 June 2003. It should be noted that the provisions relating to the giving of information prior to entering into conditional fee agreements do not apply to simple CFAs. Apart from simplifying the requirements in certain types of conditional fee agreements, solicitors will be able to agree lawfully with their clients not to seek to recover by way of costs anything in excess of what the court awards, or what is agreed will be paid, and will no longer be prevented from openly contracting with their clients on such terms.[91] The indemnity principle is therefore modified to some extent. Similar consequential amendments have been made to the Collective Conditional Fee Agreements Regulations 2000.

3.69 A substantial part of the detailed consumer protection provisions were removed from the Regulations. Clients still enjoy protection under the Solicitors' Professional Rules of Practice which forbid overcharging.[92] The Rules of Practice are designed to ensure that clients are given the information

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88 Rule 45.13.
89 John Peysner, Fixing costs: settled RTA cases, NLJ 31 October 2003 at 1640-1.
90 [1998] NILR, 404.
91 Explanatory Note to the Regulations.
92 Section G.

they need in order to understand what is happening, and in particular are informed of the cost of legal services at the outset and as the case progresses. The changes were a response to a number of cases in which the losing defendant had successfully challenged the conditional fee arrangement on taxation where some small detail of the regulations had not been followed precisely. The effect was that the fee arrangement was void, meaning the defendant escaped paying costs and the plaintiff's solicitor was unable to recover costs from his client.

3.70 "CFA lite" still requires the agreement to specify:[93]

- the particular proceedings to which the agreement relates;
- the circumstances in which the fees are payable;
- the reasons for the success fee;
- that the legal representative can disclose to the court the reason for setting the success fee at the level stated in the agreement.

3.71 The 2003 Regulations also require the legal representative to specify the circumstances in which the client retains a liability and limits those circumstances to:

- failure to co-operate with the legal representative in relation to the relevant proceedings;
- failure to attend any medical or expert examination or court hearing the legal representative reasonably requested him to attend;
- failure to give necessary instructions to the legal representative; or
- withdrawal of instructions from the legal representative.

3.72 Peysner believes that "CFA lite" may not be readily used and will not have the opportunity to be thoroughly tested because: (1) solicitors do not find it attractive because disbursements cannot be recovered against their clients in any event; (2) there may be difficulties in tying in ATE insurance cover to "CFA lite"; and (3) there is as yet no Law Society approved client agreement in relation to "CFA lite".[94]

Possible further legislative changes

DCA Consultation Paper June 2003

3.73 In June 2003, the Department for Constitutional Affairs issued a

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93 Regulation 3A(4).

94 John Peysner, cited above at 1641. No model CFA-lite agreement was drafted. – see D Bentley, *Costing free work*, Law Society Gazette 22 July 2004 at 20.

consultation paper entitled *Simplifying CFAs* which looked at the detailed requirements in the Conditional Fee Agreements Regulations 2000, the Collective Conditional Fee Agreements Regulations 2000 and the Membership Organisation Regulations 2000 to see whether they were still appropriate in view of the developments in case law and the legal services market. Given concerns that the secondary legislation was too complicated and did not reflect the actual needs of consumers, the consultation paper aimed to promote discussion on whether and how the secondary legislation could be simplified.

Conditional Fee Agreements Forum 2003

3.74 A month after the launch of the 2003 consultation paper, the Civil Justice Council hosted a conditional fee agreements forum which was attended by senior members of the judiciary, the Law Society, the Association of Personal Injury Lawyers, the General Council of the Bar, the Trades Union Congress, the Association of British Insurers, and leading practitioners. There was general agreement that the April 2000 regime was not working effectively enough and that further reform was needed.

3.75 The common theme was that, taking "CFA lite" as a starting point, the regulatory requirements could be drastically simplified by leaving minimal provisions in the regulations while other provisions should be moved to professional rules. Although there was some concern over the Law Society's ability to police irregularities, most thought that this could be addressed.

DCA Consultation Paper June 2004

3.76 In June 2004, the Department for Constitutional Affairs (the DCA) issued a further consultation paper entitled "*Making simple CFAs a reality – A summary of responses to the consultation paper Simplifying Conditional Fee Agreements and proposals for reform.*" The consultation ended on 21 September 2004. The main proposals are:

(1) Simplifying the regulations

The DCA concluded that the Conditional Fee Agreements Regulations 2000 and the Collective Conditional Fee Agreements Regulations 2000 (collectively "the 2000 Regulations") thought to be appropriate at the time of their introduction to safeguard the interests of consumers have on the whole played a limited role in this regard, and "*have in practice only served to make [conditional fee agreements] far too complex, less transparent and open to technical challenges from defendants …*".

The DCA believes that the process of simplication, which started with the introduction of "CFA lite" in June 2003, should be continued. The DCA therefore proposes to revoke the 2000

Regulations and replace them with one set of regulations covering collective conditional fee agreements as well. The DCA also proposes to remove as far as possible the detailed client care and costs information requirements from the 2000 Regulations, and to leave these areas to be regulated by the professional bodies' conduct rules.

(2) Recoverability

The DCA found that the recoverability of success fees and ATE insurance premiums had been tarnished by satellite litigation over costs and, to some extent, had been at the heart of many of the recent problems relating to costs in personal injury litigation. However, the behaviour of some lawyers, intermediaries and defendant insurers had played a part in the problems encountered.

The DCA referred to the introduction on 1 June 2004 of fixed recoverable success fees for all road traffic accident claims run under conditional fee agreements. This is likely to be extended to employers' liability accident cases shortly. This development may help to establish a more predictable and stable conditional fee regime.

To assess the impact of recoverable success fees and ATE insurance premiums on the outcome of personal injury claims, the DCA has commissioned a comprehensive study by Professor Paul Fenn, Dr Neil Rickman and Dr Alistair Gray. The report is scheduled to be completed in 2005.

(3) Defamation cases

The media organisations have mounted a campaign against the use of conditional fees in defamation cases, claiming that they inhibit the right to freedom of expression and encourage unmeritorious libel claims. The following arguments have been put forward:

- Conditional fees inhibit media organisations from running a legitimate defence and provide defamation claimants with an unfair advantage. The financial impact inhibits the activities of media organisations and breaches their right to a fair trial. This is the so-called "ransom effect".

- Conditional fees encourage/enable claimants with weak cases to litigate. Solicitors take on hopeless cases on a speculative basis, contrary to the principal aims of the conditional fees regime which are: to improve access for those with meritorious claims, to discourage weak claims

and to enable successful claimants to recover reasonable costs.

- Success fees produce excessive costs (when combined with already relatively high hourly rates) and there is an insufficiently competitive market to control lawyers' fees. Lawyers enter into conditional fee agreements with 100% success fees even for the most straightforward cases, and the odds in defamation cases are stacked against the defendant where the claimant has a conditional fee agreement and no ATE insurance. Conditional fees therefore inhibit freedom of expression and curb investigative reporting. Editors may become risk-averse. This is the so-called "chilling effect".

- Conditional fees encourage litigation rather than alternative dispute resolution such as provided by the Press Complaints Commission.

- Conditional fees are being used by rich claimants who could afford to pay conventional legal fees.

The DCA referred to the decision of the Court of Appeal in *Adam Musa King v Telegraph Limited*,[95] which concerns a defamation action brought under a conditional fee agreement without any ATE insurance cover. The Court of Appeal has set out some findings and guidance, of which extracts are reproduced below:

- *"… As a general rule, Parliament has decided that it is appropriate to order a party opposed to one funded by a CFA to pay costs at a level that would not ordinarily be regarded as reasonable or proportionate. Defamation proceedings, however, represent a potential infringement of the right to freedom of expression guaranteed by ECHR Article 10(1), and a particularly sensitive approach is required to costs issues." [para 96]*

- *"What is in issue in this case, however, is the appropriateness of arrangements whereby a defendant publisher will be required to pay up to twice the reasonable and proportionate costs of the claimant if he loses or concedes liability, and will almost certainly have to bear his own costs (estimated in this case to be about £400,000) if he wins. The obvious unfairness of such a system is bound to have the chilling effect on a newspaper exercising its right to freedom of expression … and to lead to the danger of self imposed restraints on publication which he so much feared." [para 99]*

[95] [2004] EWCA (Civ) 613.

- *"It cannot be just to submit defendants in these cases, where their right to freedom of expression is at stake, to a costs regime where the costs they will have to pay if they lose are neither reasonable nor proportionate and they have no reasonable prospect of recovering their reasonable and proportionate costs if they win." [para 101]*

- *"There are three main weapons available to a party who is concerned about extravagant conduct by the other side, or the risk of such extravagance. The first is a prospective costs capping order of the type I have discussed in this judgment. The second is a retrospective assessment of costs conducted toughly in accordance with CPR principles. The third is a wasted costs order against the other party's lawyers, but this is not the time or place to discuss the occasions when that would be the appropriate weapon." [para 105]*

The Law Commission had published a scoping study about the perceived abuses of defamation procedure in May 2002.[96] A section was devoted to conditional fee agreements and the Commission tentatively suggested that "*the current arrangements*" might constitute an infringement of articles 6 and 10 of the European Convention on Human Rights.

Despite the criticisms launched at the use of conditional fees in defamation cases, the DCA does not propose to legislate to restrict the use of conditional fees in these actions. The DCA believes that conditional fees help ensure that the ability to pursue a defamation claim is no longer just the preserve of the rich. Otherwise, meritorious case such as *Walker v Newcastle Chronicle and Journal Ltd,*[97] would not have been possible. It supports the vigorous use of the existing case management and costs control powers in the Civil Procedure Rules to ensure reasonable and proportionate behaviour and costs on both sides.

(4) *Pro bono* cases

Prior to 1995, because of the costs indemnity principle, lawyers acting on a *pro bono* basis could not recover any costs from the other side even if they won the case. The introduction of conditional fees has had a positive impact on the amount of *pro*

96 Aspects of Defamation Procedure – <www.lawcom.gov.uk/files/defamation.pdf>.

97 November 2000. The 'Sunday Sun' and the 'Evening Chronicle' published some articles in which it was alleged that the Claimant had pursued a 'Fatal Attraction' campaign of revenge against her former lover including the attempted murder of his wife. The Defendant apologised to the Claimant and accepted that none of the allegations were true. The Defendant paid the Claimant damages and her costs.

bono type litigation undertaken: solicitors took on more *pro bono* cases since there was now the ability to recover costs from the losing opponent, whilst agreeing clients would not have to bear costs if the claim failed. The 2003 amendments created "CFA lite", a simplified form of conditional fee agreement, and offered a simpler and more suitable vehicle for lawyers acting for clients on a *pro bono* basis to recover reasonable costs from opponents and to pass those costs to the relevant charitable *pro bono* organisation to support *pro bono* work.

The Attorney General's Pro Bono Committee is working on the project and considers the suggested approach is technically feasible, though the details and safeguards have yet to be worked out.

The DCA supports the Pro Bono Committee's proposals and will continue working with relevant bodies to facilitate the use of conditional fees in *pro bono* cases.

The use of conditional fee agreements in England

3.77 The 2004 Consultation Paper sets out the Department for Constitutional Affairs' conclusions in relation to the issues raised in the 2003 consultation exercise. Conditional fee agreements have been used primarily and extensively for personal injury litigation and it appears that a greater number of injured parties are making claims. It might therefore be said that the objective of increasing access to justice has been achieved. There are, however, a number of inter-related factors which are difficult to separate:

- The substantial cutback in the availability of legal aid has inevitably forced more potential claimants to make use of conditional fee agreements.

- Conditional fee agreements have reshaped the whole claims industry and extensive advertisements are now made by claims management companies and by some personal injury lawyers. This has raised awareness that claims are possible, and has led to more claims being brought.

- For the middle-income claimant who is not wealthy but is not eligible for legal aid, making a claim is now a possibility, and he can bring a claim with no costs liability at all. The fact that a claimant can now litigate without financial exposure is balanced by the fact that only cases with a reasonable prospect of success will be taken on by lawyers on a conditional fee basis.

- The reforms of the conditional fee regime in 2000 coincided with the extensive shake-up of civil procedure, and it is not always easy to separate the effect of pre-action protocols and

procedural reforms from the effect of conditional fee arrangements.

3.78 Conditional fee agreements are generally being used in relatively straightforward claims. If a claim involves significant work to assess its merits, a conditional fee agreement is not normally obtainable. Therefore, it will be easy for a claimant in a simple road traffic case to find a lawyer willing to work on a conditional fee basis, whereas a claimant in a complex clinical negligence case is much less likely to be able to do so. Almost all conditional fee agreements are accompanied by some form of insurance arrangement, primarily to cover the risk of paying the other side's legal costs if the case is lost.

3.79 Conditional fee agreements have also been used for libel claims where legal aid was not available before. They are used in cases where the solicitors would have acted *pro bono* in the past, but can now effectively act without charge and recover costs from the losing opponent if the case is won. They are used by liquidators and trustees in bankruptcy, where the insolvent company or individual has good claims, but the estate lacks funds to pursue those claims.

3.80 As for commercial actions, conditional fee agreements are used only to a limited extent. A number of commercial firms decline to operate on a conditional fee basis, but there is also evidence that large organisations with many claims are able to force their solicitors to work on a conditional fee basis by commercial muscle. Litigants from, for example, the United States, who have to pursue a claim in England & Wales, now expect their solicitor to act on a conditional fee, since this is closer to what they would be accustomed to at home.

3.81 There does not appear to have been any explosion of speculative or spurious litigation. In fact, anecdotal evidence suggests that since the solicitors' firm must fund the litigation until its conclusion, there is less tendency to pursue all possible avenues and a greater tendency to be more cost conscious/effective in a conditional fee arrangement.

The future of conditional fee agreements

3.82 According to Greenslade,[98] a fundamental review of the entire conditional fee agreement regime by the Department of Constitutional Affairs is pending, and the 2003 Regulations are likely to be a stop-gap.

3.83 On 10th August 2005, the Department for Constitutional Affairs ("the DCA") published a paper summarising the responses to the June 2004 consultation paper. The DCA concluded that:

[98] Greenslade on Costs, at N1.026.

- The fear of consumers being overcharged and the feeling that the client needed to be protected through the regulations led to the comprehensive, but in practice, unworkable regulations. As a major step forward to stabilise the conditional fee regime, the existing Conditional Fee Agreements Regulations and Collective Conditional Fee Agreements Regulations will be revoked from 1 November 2005.

- The primary legislation, being section 27 of the Access to Justice Act 1999, will be relied upon to provide the minimum legislative framework for the use of conditional fee agreements by legal representatives.

- Client care and guidance matters will be dealt with in the Law Society's professional rules of conduct, supporting costs guidance and a new model conditional fee agreement. The DCA would work closely with the Law Society and relevant stakeholders to help develop the appropriate model conditional fee agreements to support the new regime.

- The DCA did not plan to use legislation to restrict the use of success fees in defamation cases and other publication proceedings. The DCA would support the Civil Justice Council's initiatives to facilitate a mediated solution to the dispute between the media organisations and claimant practitioners in defamation or other publication proceedings in relation to concerns over the use of conditional fee agreements.[99]

3.84 Against this background of successive changes in legislation and rules, the common law, as we shall see in the next chapter, has been developing rapidly. The outcome is that the law governing conditional fees is now complex, and raises novel practical problems with significant potential pitfalls for legal practitioners and clients alike.

[99] On 26 May 2005, the House of Lords considered an appeal in the case of *Campbell v MGN Ltd* concerning the recovery of success fees. The judgment is expected in autumn 2005 and the DCA will consider the judgment to see what measures, if any, need to be taken to ensure the guidance given by the House of Lords is taken forward.

Chapter 4

Problems and litigation in England

Introduction

4.1 The new funding regime for civil litigation involving the use of conditional fees and after-the-event insurance is still at an early stage of development with many uncertainties unresolved. These uncertainties have sparked litigation concerning issues such as the reasonableness and recoverability of success fees and insurance premiums, problems posed by the costs indemnity rule and the position of other forms of event-triggered fees at common law. These will each be examined in turn in this chapter.

Litigation on the recoverability of success fees and insurance premiums

Callery v Gray

4.2 The case of *Callery v Gray,*[1] decided by the House of Lords in 2002, is illustrative of the uncertainties encountered even in a straightforward personal injury claim arising from a traffic accident.

4.3 On 2 April 2000, Mr Callery was a passenger in a car driven by Mr Wilson, which was struck side-on by a vehicle driven by Mr Gray, who was insured by the Norwich Union. Mr Callery sustained minor injuries and instructed Amelans, solicitors who specialised entirely in personal injury litigation and processed such claims on a large scale. On 28 April 2000 he signed a conditional fee agreement (CFA) which provided for a success fee of 60%. On 4 May 2000 he took out an ATE insurance policy with Temple Legal Protection Ltd ("Temple") for a premium of £367.50 inclusive of insurance premium tax. On the same day, Amelans wrote a standard letter of claim to Mr Gray, which he passed on to his insurers. On 19 May 2000, Norwich Union wrote back admitting liability. A medical report was obtained and on 12 July 2000 Amelans made a Part 36 offer to accept £3,010 and costs. On 24 July 2000, the Norwich Union made a counter-offer of £1,200. On instructions from Mr Callery, Amelans telephoned Norwich Union and agreed to accept £1,500 and reasonable costs. This was confirmed on 7 August 2000.

4.4 Amelans submitted a bill for £4,709.35 as legal costs and £350 for the ATE insurance premium. The parties were unable to agree on what

[1] (Nos 1 and 2) [2002] 1 WLR 2000-2032.

constituted reasonable costs. The parties accordingly commenced costs-only proceedings pursuant to Civil Procedure Rules, rule 44.12A. The judge ruled that a success fee of 40% (instead of 60%) was reasonable and that both the success fee and the insurance premium were recoverable in costs-only proceedings.

4.5 The defendant's insurers took the view that important points of principle were at stake with implications for personal injury litigants and insurers generally. Leave was obtained to argue the case before the Court of Appeal which dealt with the issues in two judgments.

4.6 The Court of Appeal[2] identified three main issues on the appeals: first, whether an ATE premium could be recovered in costs-only proceedings under rule 44.12A of the Civil Procedure Rules ("the jurisdiction issue"); second, the stage of a dispute at which it was appropriate to enter into (a) a conditional fee agreement and (b) an ATE policy ("the prematurity issue"); and third, the reasonableness of the claimant's (a) success fee and (b) ATE premium ("the reasonableness issue").

The jurisdiction issue

4.7 In relation to the jurisdiction issue, the Court of Appeal held that on a proper construction of section 29 of the Access to Justice Act 1999 and the Civil Procedure Rules, rule 44.12A, the ATE premium could, in principle, be recovered as part of a claimant's costs, even where the claim had settled without the need for substantive proceedings. This point was not raised in the appeal to the House of Lords.

The prematurity issue

4.8 Given that both the success fee charged by the claimant's solicitors and the ATE premium charged by the claimant's insurers were to be paid by the defendant and/or his insurer, the defendant argued that the success fee and the cost of taking out ATE insurance should only be recoverable where sufficient information was available to form a reasonable prognosis of the risk involved in a claim. The defendant further argued that a claimant could not reasonably incur these liabilities until the reaction of the defendant to a claim was known and the merits of any defence raised had been considered. At that point, so the defendants argued, it would be apparent whether there was a risk that the claim might fail, which would make it reasonable to enter into a conditional fee agreement and take out ATE insurance, and then to assess the appropriate uplift and insurance premium having regard to an informed appraisal of the extent of the risk that the claim might fail. The defendant maintained that the appropriate time to obtain ATE insurance was at the end of the protocol period, (ie three months from the notification of the claim). The defendant pointed out that since over 90% of

[2] [2001] 1 WLR 2112.

cases could be expected to settle (and might well settle) in the protocol period, the defendant should be given a fair chance to settle the case without incurring liability for additional costs.[3]

4.9 The claimants, on the other hand, contended that it was reasonable for a claimant to take out ATE insurance and enter into a conditional fee agreement when the claimant first instructed a solicitor to pursue his claim, so that the claimant need not be concerned that by giving instructions to the solicitor, he was exposing himself to liability for costs.[4]

Court of Appeal decision

4.10 The Court of Appeal held that, in modest and straightforward damages claims following road traffic accidents, it would normally be reasonable for a claimant to enter into a conditional fee agreement and take out ATE insurance cover when he first instructed his solicitor.[5]

Government policy

4.11 The Court of Appeal pointed out that the purposes of the new regime were: first, to facilitate access to justice on the part of those who could not afford the costs of litigation; and second, to reduce the burden of legal aid in relation to certain categories of case where it had previously been available.[6] It was an inevitable consequence of Government policy that unsuccessful defendants should be subjected to an additional costs burden. The Court of Appeal accepted that the new regime tended to remove from claimants the incentive to control costs, and hence the role of the court in administering the new regime was particularly important.[7]

Policy and practical considerations

4.12 The Court of Appeal further said that, although they saw the force of the defendant's submission, the prejudice to the defendants was not as clear as was suggested and that it was outweighed by the legislative policy and by the following practical considerations:

> *"(i) If the new regime is to achieve its object, the legal costs of claimants whose claims fail should fall to be borne by unsuccessful defendants …. On these appeals the court has to decide whether to permit liability for success fees to be apportioned in relatively small amounts among many unsuccessful defendants, or to insist on an approach under which they will be borne in much larger amounts by those unsuccessful defendants who persist in contesting liability.*

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3 Paras 87-89, 98.
4 Para 90.
5 Paras 99-100.
6 Para 92.
7 Para 95.

(ii) If the latter alternative is adopted, the defendants who contest liability will not share liability for costs in a manner which is equitable. Where there is a strong defence which it is reasonable to advance, a larger uplift will be appropriate than where a defendant unreasonably persists in contesting liability despite the fact that the defence is weak. Thus the more reasonable the conduct of the defendant, the larger the uplift that he will have to pay if his defence fails.

(iii) In relation to claims arising out of road accidents, where defendants will be insured, the same insurers will often be sharing the costs involved, whether in the form of many uniform small uplifts or fewer large uplifts.

(iv) So far as insurance premiums are concerned, these will produce cover which benefits the defendants, for they will ensure that costs are awarded against unsuccessful claimants and that such awards are satisfied.

(v) Defendant interests, with the assistance of the court, should be able to restrict uplifts and insurance premiums to amounts which are reasonable having regard to overall requirements of the scheme. In saying this we are contemplating a position where there will be adequate data to enable informed judgment of the amount of uplift and the size of insurance premiums that are reasonable in circumstances such as those before the court. We are well aware that that position has not yet been reached and that, on these appeals, we are faced with doing our best on very sketchy data. We have had particular regard to the fact that the representations and evidence submitted after the hearing have not been tested or analysed in the course of oral argument.

(vi) Claimants naturally want to know at the outset that a satisfactory arrangement to cover the costs of litigation has been made which provides sufficient protection for them, no matter what the outcome.

(vii) Claimants incur liabilities for costs to their legal advisers as soon as they give them instructions. Once a defendant starts to incur costs in complying with a protocol, the claimant will be exposed to liability for those costs if proceedings are commenced.

(viii) Solicitors and claims managers are anxious to be able to offer legal services on terms that the claimant will not be

required to pay costs in any circumstances. This will assist access to justice.

(ix) There is the overwhelming evidence from those engaged in the provision of ATE insurance that unless the policy is taken out before it is known whether a defendant is going to contest liability, the premium is going to rise substantially. Indeed the evidence suggests that cover may not be available in such circumstances."[8]

4.13 For these reasons, the Court of Appeal concluded that where, at the outset, a reasonable uplift had been agreed and ATE insurance at a reasonable premium had been taken out, these costs would be recoverable from the defendant if the claim succeeded, or if it was settled on terms that the defendant pay the claimant's costs.

The House of Lords decision

4.14 Dissatisfied with the Court of Appeal's decision, the defendant took the case before the House of Lords, whose decision was delivered in June 2002.[9] The House of Lords declined to interfere with the Court of Appeal's ruling because it was pre-eminently the responsibility of the Court of Appeal, not the House of Lords, to supervise the developing practice of funding litigation by conditional fee agreements and ATE insurance. Since the House of Lords could not respond to changes in practice with the speed and sensitivity of the Court of Appeal, it should in general be slow to intervene in such a case, especially given the early stage in the practical development of the new regime, the sparsity of reliable factual material, the meagre experience of the market, the difficulty of discerning trends and the provisional nature of the Court of Appeal's guidance to be reviewed in the light of increased knowledge and experience. It may be useful to set out some of the observations made by the House of Lords.

4.15 In relation to the prematurity issue, Lord Scott agreed:

"… with the Court of Appeal's proposition that it is reasonable for a claimant to enter into a CFA with his solicitor at their first meeting and before the defendant's reaction to the claim is known. … After all, the fees clock begins ticking as soon as a solicitor is instructed."[10]

However, Lord Scott (dissenting on the prematurity issue) commented that it was not reasonable, in a cost assessment context, for a claimant to take out an ATE policy at a time when litigation was highly unlikely.[11]

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8 Para 99.
9 [2002] 1 WLR 2000.
10 Para 107 at 2026.
11 Para 108 at 2026.

4.16 Lord Scott said the Court of Appeal's decision on the issue seemed to have been:

> *"based on the evidence placed before the court about the ATE insurance market and the Court of Appeal's concern that unless premium recovery under costs orders were allowed in such commonplace, minimal risk cases as Mr Callery's, the market in ATE insurance policies might wither."*[12]

Lord Scott said that whilst he would accept that the size of the premiums might rise if recovery of premiums was restricted to cases where there was a fair likelihood of litigation, he would certainly not be prepared to accept that cover would be unavailable.[13]

4.17 In fact, Lord Scott opined that the prematurity issue should not be judged by reference to arguments about the impact on the ATE insurance market. He said that:

> *"The correct approach for costs assessment purposes to the question whether an item of expenditure by the receiving party has been reasonably incurred is to look at the circumstances of the particular case. The question whether the paying party should be required to meet a particular item of expenditure is a case specific question. It is not a question to which the macro economics of the ATE insurance market has any relevance. If the expenditure was not reasonably required for the purposes of the claim, it would, in my opinion, be contrary to long-established costs recovery principles to require the paying party to pay it."*[14]

4.18 Lord Scott disagreed with the Lord Chancellor's Department's submission that "*access to justice would be restricted if claimants could not insure against liability for costs from the point they instructed a solicitor.*"[15] Lord Scott pointed out that there was "*nothing to prevent claimants from taking out ATE policies as soon as they instruct a solicitor … he can do so but cannot then reasonably expect the defendant to pay for it.*"[16]

4.19 Zander in his article[17] examined the case and pointed out that Lord Scott had a powerful argument. He also pointed out that in the subsequent Claims Direct Test Cases[18] Lord Scott's dissenting view on the prematurity issue seemed to have been followed by Chief Costs Judge Master Hurst who said *obiter* that:

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12 Para 111 at 2027.
13 Para 113 at 2028.
14 Para 114 at 2028.
15 Para 118 at 2029.
16 As above.
17 "Where are we now on Conditional Fees? – or why this Emperor is Wearing Few, if any, Clothes", Modern Law Review – Vol 56, No 6, Nov 2002.
18 [2001] EWCA Civ 428, [2002] All ER (D) 76 (Sep), accessible on <www.courtservice.gov.uk>.

> *"Where an incident occurs, particularly a minor road traffic accident causing slight injury and where the liability insurer has from the outset accepted liability for the occurrence, it will generally be disproportionate and unreasonable to take out an ATE policy."*[19]

Master Hurst, however, did not give reasons for apparently rejecting the "macroeconomic" considerations about the ATE insurance market in favour of Lord Scott's views. Therefore, Zander believed it was difficult to be certain as to the significance of Master Hurst's dictum and, until doubts were clarified by the higher courts, there would be continuing uncertainty. Another author[20] commented that Master Hurst's *obiter* opinion was subsidiary to *Callery*, especially since no evidence on the issue was heard.

Reasonableness of the success fee

Court of Appeal decision

4.20 With regard to the issue of whether the amounts of the success fee and the ATE premium were reasonable, the Court of Appeal pointed out that there had not been any authoritative guidance from the higher courts as to the level of success fee which would be considered reasonable on an assessment of costs in litigation supported by a conditional fee agreement.[21] The difficulty is summarised by the Association of Personal Injury Lawyers ("APIL"):

> *"The court is faced with a difficult balancing exercise in setting guidelines for a new regime where there is little experience or published data to rely upon. Allowing success fees to be set too high compared to the risk being run will lead to inflation of fees paid to lawyers by the public who pay insurance premiums. But allowing them to be fixed too low compared to the risk being run will lead to lawyers only being able to take on the most certain cases and a denial of access to justice to some of the most vulnerable people in society."*[22]

4.21 The Court of Appeal stressed that any general guidance provided in the *Callery v Gray* case was given in the context of modest and straightforward claims for compensation for personal injuries resulting from traffic cases. The Court believed that it was reasonable to proceed on the premise that at least 90% of such claims would settle without the need for proceedings, or would succeed after proceedings had been commenced. After careful consideration the Court concluded that, where a CFA was agreed at the outset in such cases, 20% was the maximum uplift that could reasonably be agreed.

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19 Para 231.
20 Mark Harvey, *"Guide to Conditional Fee Agreements"*, Jordans at 134.
21 Para 101.
22 Para 102.

Two-stage success fee

4.22 Though the issue was not of direct relevance to the case, the Court of Appeal suggested that a two-stage success fee could be considered, so that a higher success fee would be applicable if the case did not settle. This would be subject to a rebate, however, if the case did in fact settle before the end of the protocol period. The Court of Appeal said that:

> *"a two-stage success fee would have the advantage that the uplift would more nearly reflect the risks of the individual case, so that where a claimant's solicitor had to pursue legal proceedings, this would be in the knowledge that, although a significant risk of failure existed, the reward of success would be that much the greater. Where, on the other hand, the claim settled as a consequence of an offer by the defendant, he or his insurer would have the satisfaction of knowing that he had ensured that the success fee would be reduced to a modest proportion of the costs."*[23]

4.23 With regard to the risk that a two-stage success fee would encourage claimants' solicitors to take claims beyond the protocol stage in order to benefit from the higher success fee, the Court of Appeal pointed out that such conduct would be prevented if the defendant had made a formal settlement offer, thus putting the claimant at risk as to costs.[24]

House of Lords decision

4.24 Lord Bingham observed that there was "*obvious force in the appellant's contention that even a 20% success uplift provided a generous level of reward for Mr Callery's solicitors given the minuscule risk of failure.*"[25] However, he believed that the House should not intervene because: first, the Court of Appeal had the responsibility for monitoring the developing practice on the issue and the House should ordinarily be slow to intervene; and second, the issue was at a very early stage in the practical development of the new funding regime, when reliable factual material was sparse, market experience was meagre and trends were hard to discern.[26]

4.25 Lord Nicholls agreed with the two reasons given by Lord Bingham and dismissed the appeal. However, he criticised the present state of the new funding arrangements for personal injuries claims as being unbalanced and unfairly prejudicial to liability insurers and motorists generally.[27]

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[23] Para 111.
[24] Para 112.
[25] Para 7 at 2004.
[26] Para 9 at 2005.
[27] See paras 12-16 at 2006. See also para 3.50 above.

4.26 Lord Hope and Lord Scott observed that the 20% success fee seemed unduly high for a low risk case, but declined to interfere.

4.27 Lord Hoffmann also declined to interfere, but made some telling observations on the issue of reasonableness of the success fee. He said that what in fact determined the success fee was what costs judges had been willing to allow in comparable cases. However, he doubted whether the courts had, or could have, the material on which to make sensible decisions. He further said that:

> *" … The traditional function of the costs judge, or taxing master, as he used to be called, was to decide what fees were reasonable by reference to his experience of the general level of fees being charged for comparable work. But this approach only makes sense if the general level of fees is itself directly or indirectly determined by market forces. Otherwise the exercise becomes circular and costs judges will be deciding what is reasonable according to general levels which costs judges themselves have determined. In such circumstances there is no restraint upon a ratchet effect whereby the highest success fees obtainable from a costs judge are relied upon in subsequent assessments.*
>
> *The matter becomes even more difficult when a solicitor 'carrying on litigation business on a large scale' is entitled, as the Court of Appeal have said, at p 2131, para 83, to fix success fees to ensure 'that the uplifts agreed result in a reasonable return overall, having regard to his experience of the work done and the likelihood of success or failure of the particular class of litigation'. The costs judge has simply no way of knowing whether the solicitor is carrying on business on a large enough scale to justify such an approach, still less what level of success fees would give him a 'reasonable return overall'. Such matters are traditionally outside the consideration of costs judges."*

4.28 Lord Hoffmann said that once a global approach designed to produce a reasonable overall return for solicitors was invoked, the court had moved away from its judicial function and into the territory of legislative or administrative decisions. Lord Hoffmann's view was that it would be more rational to have levels of costs fixed by legislation.

4.29 Zander commented that:

> *"Lord Hoffmann's speech exposed to public gaze the complete intellectual emptiness of the Court of Appeal's approach to the fixing of success fees which has now been endorsed by the House of Lords. The whole business is based on strings and mirrors. There is nothing solid there at all."* [28]

[28] In his article "Where are we now on Conditional Fees? – or why this Emperor is Wearing Few, if any, Clothes", cited above, at 927.

It is small wonder, therefore, that the issue of the reasonableness of success fees in small straightforward claims was subject to review again shortly afterwards in *Halloran v Delaney,*[29] which will be discussed later in this chapter.

Reasonableness of the ATE premium

Court of Appeal decision

4.30 After considering a report by Master O'Hare on ATE premiums, the Court of Appeal in a later judgment, in *Callery v Gray* (No 2)*,*[30] considered the defendant's appeal against the amount of the insurance premium. The Court of Appeal dismissed the defendant's contention that the insurance premium was unreasonably high for a simple passenger claim and gave the following opinion:

> *"When considering whether a premium is reasonable, the court must have regard to such evidence as there is, or knowledge that experience has provided, of the relationship between the premium and the risk and also the cost of alternative cover available. As time progresses this task should become easier. In the present case it is not easy as both data and experience are sparse … . In the circumstances, the amount of the premium does not strike us as manifestly disproportionate to the risk. We do not find it possible to be more precise than this. … The premium was one tailored to the risk and the cover was suitable for Mr Callery's needs. The policy terms also had the attractive feature that they gave his solicitors control over the conduct of the proceedings on his behalf, without any involvement by a claims manager until a settlement offer was made. We have concluded that the court below was right to find that the premium was reasonable."*[31]

4.31 However, the Court of Appeal stressed that the judgment should not be treated as determining once and for all that a premium of £350 was reasonable in similar cases. The court said that as further information and experience about the market became available, then it would be possible to determine the reasonableness of insurance premiums on a sounder basis.[32]

House of Lords decision

4.32 Lords Bingham, Nicholls and Hope did not address the issue of the reasonableness of the ATE premium. Lord Hoffmann applied the same analysis as he had already directed to success fees. He referred to the ATE

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29 New Law Journal 20 September 2002.
30 [2001] 1 WLR 2142.
31 Paras 69-70 at 2159.
32 Para 71 at 2159.

insurers' claim that they could not obtain a reasonable premium income unless everyone took out insurance when they first instructed solicitors. This was the principle upon which some insurers delegated to solicitors the authority to issue policies. The Court of Appeal accepted these arguments and stated that "*it is hardly surprising that delegated authority arrangements will only work successfully if the solicitor does not 'cherry-pick' by taking out ATE insurance only in risky cases.*"[33] Lord Hoffmann, however, pointed out that when ATE insurance first made its appearance, the premiums had been much lower than current rates. With the present much higher premiums, it was an open question whether it was necessary to insist that all claimants take out policies in order to keep insurers in business.

4.33 Lord Hoffmann said that ATE insurers did not compete on the premiums charged; instead, they competed for solicitors who would sell or recommend their product by offering the most profitable arrangements. The only restraining force on the premium charged was the amount that the costs judge would allow on an assessment. Lord Hoffmann believed:

> *"… the costs judge has absolutely no criteria to enable him to decide whether any given premium is reasonable. On the contrary, the likelihood is that whatever costs judges are prepared to allow will constitute the benchmark around which ATE insurers will tacitly collude in fixing their premiums."*[34]

As the premiums were not paid either by the claimants who took out the insurance or by the solicitors who advised or required them to do so, market forces were insufficient to produce an efficient use of resources. Hence, regulation should be considered necessary.[35]

Comments on Callery v Gray

4.34 Zander has pointed out[36] that there was widespread agreement amongst the senior judiciary that the determination of costs was an area in total chaos. Despite that widespread concern, Zander believed that it was not likely that the Lord Chancellor would accept Lord Hoffmann's suggestion that the Government should intervene to regulate success fees and ATE premiums.

Halloran v Delaney – from 20% success fee to 5%

4.35 This case[37] concerned a straightforward traffic accident in which the claimant entered into a Law Society model conditional fee agreement. The success fee was set at 40% of the basic charges, and ATE insurance was taken out at a premium of £840. The claim was settled save for costs, and costs-only proceedings were taken out. The parties subsequently agreed that

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33 At p 2128, para 67.
34 At p 2012-3, para 44.
35 At p 2013, para 44.
36 In his article "Where are we now on Conditional Fees? – or why this Emperor is Wearing Few, if any, Clothes", cited above, at 930.
37 New Law Journal 20 September 2002.

the amount of the success fee and the ATE premium were recoverable. The sole item in dispute was the costs of the costs-only proceedings. The Court of Appeal held that on the true construction of the Law Society model conditional fee agreement, the "claim" for which it provided coverage included costs-only proceedings.

4.36 The Court of Appeal then went on to express its views on success fees. Lord Justice Brooke observed that in *Callery v Gray*,[38] the Court of Appeal had held that in a modest and straightforward claim for compensation for personal injuries resulting from a traffic accident 20% was the maximum uplift that could reasonably be agreed, unless there was any special factor that raised apprehension that the claim might not prove to be sound. Lord Justice Brooke believed it was time to reappraise the appropriate level of success fee and said that:

> *"… in simple claims settled without the need to commence proceedings, an uplift of five per cent on the claimant's lawyers' costs should be allowed (including the costs of any costs only proceedings which are awarded to them) unless a higher uplift was appropriate in the particular circumstances of the case. That policy should be adopted in relation to all [conditional fee agreements], however structured, which were entered into on and after 1 August 2001, when both Callery v Gray judgments had been published and the main uncertainties about costs recovery had been removed."*

4.37 Lord Justice Brooke recommended the development of the two-stage approach to success fees which had been discussed *obiter* in *Callery v Gray*. He said that:

> *"A success fee can be agreed which assumes the case will not settle, at least until after the end of the protocol period, if at all, but which is subject to a rebate if it does in fact settle before the end of that period. Thus, by way of example, the uplift might be agreed at 100%, subject to a reduction to 5% should the claim settle before the end of the protocol period."*[39]

Comments on Halloran v Delaney

4.38 There are uncertainties as to how the cases of *Callery* and *Halloran* can be reconciled. On the one hand, *Halloran* represents the latest decision on the level at which success fees should be fixed, bearing in mind that the Court of Appeal in *Callery* had stressed earlier that the figure of 20% was based on very limited data and that it would be desirable to review that figure when more data became available.[40] On the other hand, the 20% figure in *Callery* was approved by the House of Lords. The comments in

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38 (Nos 1 and 2) [2002] 3 All ER 417. See discussion earlier in this chapter.

39 Para 106.

40 [2001] 1 WLR 2112 at para 105.

Halloran were made without hearing evidence or receiving submissions on the level of success fees, and the court did not seek to distinguish *Callery v Gray*.

4.39 Mark Harvey[41] has suggested that the comments on the rebated 5% success fee should be treated as *obiter*, and not as forming part of the judgment.[42] He believed that *Halloran* was at best persuasive, and that *Callery* remained good law. He suggested that law firms should resist the imposition of a 5% rebated success fee. The courts would impose such a figure regardless of what was written in the conditional fee agreement if the courts wished to do so. However, he recommended that firms should seriously consider adopting a two-stage success fee, given that *Halloran* added support to the proposal put forward in *Callery*.

4.40 Greenslade[43] has observed, however, that *Callery* has not provided the hoped for general guidance and that further developments, perhaps including statutory intervention, can be expected in this field.

The effect of BTE insurance on the recoverability of ATE premiums

Sarwar v Alam – 2001

4.41 The Court of Appeal case of *Sarwar v Alam*[44] has highlighted the uncertainty as to whether an ATE premium would be recoverable from the paying party where there was "before-the-event" (BTE) legal expenses insurance which would have covered the liability for legal expenses.

4.42 Like *Callery v Gray*, the case concerned a claim by a passenger who had suffered minor personal injuries in a road traffic accident. However, the claimant, Mr Sarwar, was claiming against the driver of the car in which he was travelling as a passenger, and not against the driver of another car. The claim was settled for a comparatively small sum at an early stage without the need to institute legal proceedings. In costs-only proceedings under Civil Procedure Rules, rule 44.12A, the defendant's insurer argued that the defendant's motor insurance policy contained a provision for legal expenses insurance which might have covered a claim made by a passenger in the insured's car against an insured driver. It was therefore unreasonable for the claimant to recover the £350 premium for ATE insurance from the defendant.

4.43 The case is of importance to insurers generally. BTE insurers believe that if BTE is available for small motor accident claims, the claimants should use it instead of incurring the extra cost of an ATE premium. ATE insurers, however, are worried that if they lose business to BTE insurers, their premiums may have to rise, or they may go out of business altogether.[45]

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41 Secretary of the Association of Personal Injury Lawyers, England.

42 In his book, *"Guide to Conditional Fee Agreements"*, Jordans 2002, pages 82-83.

43 Greenslade on Costs, at A1-035.

44 [2001] 1 WLR 125. Judgment was delivered on 19 September 2001.

45 Para 39.

4.44 Both the district judge and the judge on appeal held that the BTE insurance was available to the claimant, Mr Sarwar, and disallowed the cost of his ATE premium. The Court of Appeal, however, allowed the claimant's appeal. Lord Phillips of Worth Matravers MR observed that for a relatively minor personal injuries claim arising out of a road traffic accident:

> *"if a claimant possesses pre-existing BTE cover which appears to be satisfactory for a claim of that size, then in the ordinary course of things that claimant should be referred to the relevant BTE insurer."*[46]

On the other hand:

> *"in larger cases, or those which raised unusual or difficult issues, it would usually be appropriate for a claimant to elect to purchase an ATE – based funding arrangement in preference to invoking a BTE policy, unless it could be shown that the latter was capable from the outset of providing what they described as a bespoke service adequate to the nature of the claim."*[47]

4.45 The Court of Appeal noted that the terms of the BTE policy entitled the insurers to the full conduct and control of the claim or legal proceedings, and that they were entitled to appoint a legal representative where they regarded it as necessary. The insured person could choose an alternative legal representative only where he decided to commence legal proceedings or where there was a conflict of interest. In that event, any dispute as to the choice of legal representative or the handling of a claim would be referred to an independent arbitrator.

4.46 The Court of Appeal disagreed with the judge and considered that it was not incumbent on a passenger to rely on a defendant driver's BTE cover. The Court of Appeal accepted the submission of the Motor Accident Solicitors' Society which observed that a claimant could not be expected to rely on a BTE policy held by his opponent to fund his litigation. The Society added:

> *"… there are obvious concerns as to conflict of interest in any case where a defendant is being sued via his own policy of insurance. … Where liability is disputed, the defendant may very well have a strong personal motivation in resisting the claim (payment of an excess; loss of no-claims bonus; a stiff-necked refusal to accept the possibility that he drove carelessly …). Moreover, it is probable that many claimants would feel uneasy in entrusting the conduct of their claim to the insurer of the opposing party, and would distrust its advice where adverse to their private expectations. Justice should be seen to be done, and the rules of court should support a claimant who elects to*

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46 Para 41.
47 Para 43.

fund his claim from a source which is not only neutral and objective, but is seen to be so."[48]

4.47 It was held that representation arranged by the insurer of the opposing party, pursuant to a policy to which the claimant had never been a party, and of which the claimant had no knowledge at the time it was entered into, was not a reasonable alternative where the opposing insurer reserved to itself the full conduct and control of the claim.[49] Hence, the ATE premium was held to be recoverable from the defendant in this case.

Sarwar v Alam – 2003

4.48 The case was brought before the court again in 2003[50] and was heard by a Costs Judge, Master Rogers. The claimant was prepared to settle for £2,250 damages, but the claimant's bill of costs for £255,745.30 was disputed by the defendant. The Costs Judge decided in favour of the defendants that the costs appeared on their face to be disproportionate and the "necessary test" laid down by Lord Woolf LCJ in *Home Office v Lownds*[51] had to be applied. The issues raised at the further hearing included:

(a) whether the ATE premium of £62,500 for £125,000 cover was a reasonable sum, and
(b) whether the claimant's success fee of 100% was reasonable.

4.49 The court considered *Times Newspapers Ltd v Keith Burstein*,[52] *Ashworth v Peterborough United Football Club Ltd*[53] and other cases, and came to the conclusion that, although the premium was high, it was unlikely that the claimant's advisors could have obtained an alternative lower rate. The claimant's solicitors adduced to the court the correspondence which showed the difficulties of obtaining insurance cover, and a "tailor-made" insurance policy was likely to attract a substantially higher premium than a standard policy. Master Rogers remarked that "*Law and practice were in a state of flux and insurers were understandably reluctant to commit themselves to a large potential liability.*" Hence, Master Rogers held that the full amount of the insurance premium was recoverable.

4.50 With regard to the reasonableness of the 100% success fee claimed, Master Rogers found that "*there is a dearth of authority on the level of success fees, it being conceded that the Callery v Gray twenty percent, now downgraded to five percent by the Court of Appeal in Halloran v Delaney, is not the appropriate level for this case.*" Master Rogers referred to *Designer Guild Ltd v Russell Williams (Textile) Ltd (trading as Washington DC)* and quoted the following paragraphs:

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48 Para 54.
49 Para 58.
50 [2003] EWHC 9001. Judgment was given on 7 March 2003.
51 [2002] 2 Costs LR 279.
52 [2002] EWCH Civ 1739.
53 Unreported, but available on SCCO page of Court Service website.

"With regard to the solicitors' claim a success fee of 100% is sought. Mr Bacon produced to us the opinion of Leading Counsel prior to the CFA being entered into which put the chances of success at no more than evens. That opinion was given against a background in which the appellant company had been successful at first instance and lost in the Court of Appeal. It is quite clear that the issues were finely balanced. It is generally accepted that if the chances of success are no better than 50% the success fee should be 100%. The thinking behind this is that if a solicitor were to take two identical cases with a 50% chance of success in each it is likely that one would be lost and the other won. Accordingly the success fee (of 100%) in the winning case would enable the solicitor to bear the loss of running the other case and losing.

There is an argument for saying that in any case which reached trial a success fee of 100% is easily justified because both sides presumably believed that they had an arguable and winnable case. In this case we have no doubt at all that the matter was finely balanced and that the appropriate success fee is therefore 100%."

4.51 Master Rogers accordingly held that the 100% success fee was justified.

Re Claims Direct Test Cases

4.52 *Re Claims Direct Test Cases*[54] is another case concerning recoverability of insurance premiums. Claims Direct, a large-scale claims intermediary, provided a claims handling service to claimants with personal injury claims. The service included finance arrangements for claimants to take out a loan to pay a premium for an ATE insurance policy. Various claimants who had been successful in litigation sought to recover the amount of "premium" paid, and these attempts were challenged by a number of liability insurers. Test cases were selected for the trial of preliminary issues, and the question was whether the sum paid by the claimant was properly to be regarded as a premium within the meaning of section 29 of the 1999 Act.

4.53 The judge found that part of what was provided by Claims Direct was claims handling and only part was insurance services. The claimants appealed, contending amongst other issues that the judge had been wrong in allowing the deconstruction of a premium liability, which would give rise to endless difficulties in the assessment of costs. The Court of Appeal dismissed the claimants' appeal and held that the judge had been entitled to "lift the veil" and consider what was actually being provided in return for the payment in order to identify what should truly be treated as the premium.

[54] [2003] 4 All ER 508. Hearing date 12 February 2003.

The position of event-triggered fees at common law and problems with the costs indemnity rule

4.54 The question whether event-triggered fees could be integrated into the common law has been considered by the courts on a number of occasions over the past decade. At first, it seemed from *British Waterways Board v Norman*[55] and *Aratra Potator Co Ltd v Taylor Joynson Garrett*[56] that this was not possible. The position was later reversed, however, by the Court of Appeal in *Thai Trading Co v Taylor,*[57] which was applied in *Bevan Ashford v Yeandle Ltd.*[58] Subsequently, however, in *Awwad v Geraghty & Co*,[59] the Court of Appeal curtailed the scope of event-triggered fees that could be regarded as lawful at common law.

4.55 It is evident that the issue is not without difficulty and it may be useful to set out below the facts and arguments put forward in the main relevant decisions.

British Waterways Board v Norman

4.56 The British Waterways Board owned a number of low-cost residential properties. Mrs Norman was one of the Board's tenants. She brought a private prosecution against the Board under the Environmental Protection Act 1990 as the premises she rented were in such a state as to be prejudicial to health or a nuisance. Mrs Norman was on income support, but legal aid was not available to her since the proceedings were criminal in nature.[60] Mrs Norman approached a solicitors' firm, Michael Arnold, who found that she had a strong case. The solicitors agreed to act on the understanding that if the case was unsuccessful they would not seek payment from Mrs Norman, and would seek payment from the Board if the case was successful. There was no written contract between Mrs Norman and her solicitors.

4.57 Section 82(12) of the Environmental Protection Act 1990 empowered the court to order the defendant to pay the person bringing the proceedings an amount to compensate him for any expenses "*properly incurred*" by him in bringing the proceedings. Mrs Norman won the case, and the British Waterways Board was ordered to pay costs of £8,900. The Board argued, first, that the costs were not "*properly incurred*" by Mrs Norman because there was an agreement between her and her solicitors that the latter would not in any circumstances look to her for any part of the costs and, second, that, the agreement between Mrs Norman and her solicitors as to costs amounted to a contingency fee agreement and as such was contrary to

55 (1993) 26 HLR 232.
56 [1995] 4 All ER 695.
57 [1998] QB 781.
58 [1998] 3 All ER 238.
59 [2000] 3 WLR 1041.
60 Legal Aid Act 1988, s 21.

statute and public policy. In reply, Mrs Norman's solicitors contended that they were doing no more than assisting a person who was unable to pay a fee but who had a legitimate cause of action.

The indemnity rule

4.58 The British Waterways Board contended that, since there was an agreement, express or implied, between Mrs Norman and her solicitors that they would not look to her personally for any of the costs of bringing the prosecution, Mrs Norman had not incurred any legal expense in respect of the proceedings. It could not therefore be said that Mrs Norman had "*properly incurred*" any expenses in bringing the proceedings. In support of the proposition that if the party in whose favour the order for costs is made has not himself incurred any liability for costs then nothing is recoverable by him under the order for costs, the Board referred to *Gundry v Sainsbury.*[61] It was held in that case that the client could in no circumstances be liable for the costs payable to his own lawyers.

4.59 There was also authority[62] that the agreement as to costs need not be express. The court considered the nature of the agreement between Mrs Norman and her solicitors and concluded that "*there must have been an understanding between them amounting in law to a contract that they would not look to her for any costs if she lost.*" That was enough for the court to hold that the costs had not been "*properly incurred*" by Mrs Norman and to allow the Board's appeal. The court nevertheless went on to consider the Board's second ground of appeal.

Public policy

4.60 In relation to the Board's argument that the agreement as to costs between Mrs Norman and her solicitors amounted to a contingency fee and was therefore unlawful as contrary to public policy, the Board's lawyers referred to section 59 of the Solicitors Act 1974[63] and rule 8.1 of the Solicitors' Practice Rules 1990,[64] both of which rendered contingency fee arrangements unlawful. In reply, Mrs Norman argued that, in the light of section 58 of the Courts and Legal Services Act 1990,[65] it could no longer be said that

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61 [1910] 1 KB 645.

62 *Bourne v Colodenes Ltd* [1985] ICR 291.

63 "*(1) Subject to subsection (2) a solicitor may make an agreement in writing with his client as to his remuneration in respect of any contentious business done, or to be done, by him (in this Act referred to as 'a contentious business agreement') providing that he shall be remunerated by a gross sum, or by a salary, or otherwise, and whether at a higher or lower rate than that which he would otherwise have been entitled to be remunerated. (2) Nothing in this section or in sections 60 to 63 shall give validity to – … (b) any agreement by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding, stipulates for payment only in the event of success in that action, suit or proceeding.*"

64 "*A solicitor who is retained or employed to prosecute any action, suit or other contentious proceeding shall not enter into any arrangement to receive a contingency fee in respect of that proceeding.*"

65 "*(1) In this section 'a conditional fee agreement' means an agreement in writing between a person providing advocacy or litigation services and his client which – (a) does not relate to*

contingency fees were against public policy. The Board, however, pointed out that section 58 had no application to criminal proceedings. They added that there had been no material change in the Solicitors Act or Rules since the passing of the Courts and Legal Services Act and the intention of Parliament must therefore have been to preserve the position that it was against public policy to allow a contingency fee in a criminal case.[66]

4.61 The Board's lawyers then referred to Lord Denning's judgment in *Wallersteiner v Moir (No 2)*[67] which held, among other things, that it would be unlawful as against public policy for a solicitor to accept a retainer to conduct an action on a contingency fee basis. Lord Denning said:

> *"English law has never sanctioned an agreement by which a lawyer is remunerated on the basis of a 'contingency fee', that is that he gets paid if he wins, but not if he loses. Such an agreement was illegal on the ground that it was the offence of champerty. …*
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> *In 1967 following proposals of the Law Commission, Parliament abolished criminal and civil liabilities for champerty and maintenance but subject to this important reservation in section 14(2) of the Criminal Law Act 1967:*
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> > *'The abolition of criminal and civil liability under the law of England and Wales for maintenance and champerty shall not affect any rule of that law as to the case in which a contract is to be treated as contrary to public policy or otherwise illegal.'*
>
> *It was suggested to us that the only reason why 'contingency fees' were not allowed in England was because they offended against the criminal law as to champerty: and that, now the criminal liability is abolished, the courts were free to hold that contingency fees were lawful. I cannot accept this contention. The reason why contingency fees are in general unlawful is that they are contrary to public policy as we understand it in England."*[68]

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proceedings of a kind mentioned in subsection (10); (b) provides for that persons fees and expenses, or any part of them, to be payable only in specified circumstances." Section 58(10) reads: "*The proceedings mentioned in subsection 1(a) are any criminal proceedings …*".

66 At pages 240-241.

67 [1975] QB 373.

68 At page 393C. Lord Denning had examined the views on contingency fees in the United States and observed that "*These are powerful arguments, but I do not think they can or should prevail in England, at any rate, not in most cases. We have the legal aid system in which, I am glad to say, a poor man who has a reasonable case can always have recourse to the courts. His lawyer will be paid by the state, win or lose. If the client can afford it, he may have to make a contribution to the costs. Even if he loses, he will not have to pay the costs of the other side beyond what is reasonable – and that is often nothing. So the general rule is, and should remain in England, that a contingency fee is unlawful as being contrary to public policy.*"

4.62 The British Waterways Board's lawyers then referred to *Trendtex Trading Corporation v Credit Suisse,*[69] in which Lord Denning MR said:

> *"… Modern public policy condemns champerty in a lawyer whenever he seeks to recover – not only his proper costs – but also a portion of the damages for himself: or when he conducts a case on the basis that he is to be paid if he wins but not if he loses. As I said in Re Trepca Mines Ltd (No 2) [1963] Ch 199, 219-220:*
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> > *'The reason why the common law condemns champerty is because of the abuses to which it may give rise. The common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress evidence or even to suborn witnesses.'*
>
> *This reason is still valid after the Act of 1967."*[70]

4.63 Hence, it was clear that as late as 1980, the Court of Appeal was of the view that a contingency fee was against public policy. The Divisional Court in *British Waterways Board v Norman* therefore held, in respect of criminal proceedings, that the contingency fee impliedly agreed between Mrs Norman and her solicitors remained against public policy.[71]

Aratra Potato Co Ltd v Taylor Joynson Garrett[72]

4.64 The same principles were applied in the *Aratra* case in which the solicitors were engaged on the understanding that if the case were lost, the solicitor and own client costs would be reduced by 20%. The Divisional Court held that it was champertous and contrary to public policy for solicitors to agree a differential fee based on the outcome of litigation. The entire retainer was held to be unlawful, despite the fact that the solicitors were seeking to recover only normal costs in the event of success, and reduced costs if the case was lost.

Thai Trading Co v Taylor[73]

4.65 This case has overruled *British Waterways Board* and *Aratra Potato Co Ltd*. The case concerned a Mrs Taylor who paid a deposit for a bed from Thai Trading Co, but rejected it on delivery as unsatisfactory and refused to pay the balance of the purchase price. Thai Trading Co brought an action for the balance and Mrs Taylor counterclaimed to recover the deposit.

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69 [1980] QB 629.
70 At page 654A.
71 At page 242.
72 [1995] 4 All ER 695.
73 [1998] QB 781.

Mrs Taylor was represented by her husband, who was a solicitor, and the understanding was that he would recover his ordinary costs only if she succeeded in the action. Mrs Taylor obtained judgment with costs. On a review of taxation, the judge held that he was bound by the decisions in *British Waterways Board* and *Aratra Potato Co Ltd* to hold that the contingency fee agreement was contrary to public policy and void. He therefore held that Thai Trading Co was not liable to pay Mrs Taylor's solicitors' costs by virtue of the indemnity principle.

4.66 Giving the judgment of the Court of Appeal, Lord Justice Millett overruled *British Waterways Board* and *Aratra Potato Co Ltd* for reasons which can be conveniently divided into four main areas: legislation and rules; differentiating maintenance and champerty; changing public policy; and absence of implied contract as to costs.

Legislation and rules

4.67 Lord Justice Millett said:

> *"It should be observed at the outset that there is nothing in the Solicitors Act 1974 which prohibits the charging of contingent fees. Section 59(2) merely provides that nothing in the Act shall give validity to arrangements of the kind there specified. It does not legitimise such arrangements if they are otherwise unlawful, but neither does it make them unlawful if they are otherwise lawful.*
>
> *The Solicitors' Practice Rules 1987 by contrast provide that a solicitor engaged in any contentious business shall not enter into any arrangement to receive a contingency fee, that is to say a fee payable only in the event of success in the proceeding. There is now an exception for conditional fee agreements which satisfy the requirements of the Courts and Legal Services Act 1990. Except as there provided, therefore, it is unprofessional conduct for a solicitor to enter into any agreement even for his normal fee where this is dependent on achieving a successful result in litigation. The plaintiffs placed much reliance on this.* ***But the fact that a professional rule prohibits a particular practice does not of itself make the practice contrary to law****: see Picton Jones & Co v Arcadia Developments Ltd [1989] 1 EGLR 43. Moreover, the Solicitors' Practice Rules are based on a perception of public policy derived from judicial decisions the correctness of which is in question in this appeal."*[74] *[Emphasis added]*

[74] At page 785.

Differentiating maintenance and champerty

4.68 Lord Justice Millett said that the law governing contingent fees outside the scope of the Courts and Legal Services Act 1990 was derived from public policy relating to maintenance and champerty, and the public policy which governed the two doctrines was different and allowed for different exceptions.

4.69 The policy underlying the law of maintenance was described by Fletcher Moulton LJ in *British Cash and Parcel Conveyors Ltd v Lamson Store Service Co Ltd*,[75] in terms which were approved by Lord Mustill in *Giles v Thompson*:[76]

> *"It is directed against wanton and officious intermeddling with the disputes of others in which the [maintainer] has no interest whatever, and where the assistance he renders to the one or the other party is without justification or excuse."*

4.70 But even in former times maintenance was permissible when the maintainer had a legitimate interest in the outcome of the suit. This was not confined to cases where he had a financial or commercial interest in the result. It extended to other cases where social, family or other ties justified the maintainer in supporting the litigation. In *Neville v London Express Newspaper Ltd*[77] Lord Haldane said:

> *"Such an interest is held to be possessed when in litigation a master assists his servant, or a servant his master, or help is given to an heir, or a near relative, or to a poor man out of charity, to maintain a right which he might otherwise lose."*

4.71 Lord Justice Millett also referred to *Condliffe v Hislop,*[78] which held that it was not unlawful for a mother to provide limited funds to finance her bankrupt son's action for defamation. He found that in the Thai Trading Co. case, since Mrs Taylor was both the wife and employee of the solicitor, Mr Taylor was doubly justified in maintaining his wife's suit and the maintenance could not be unlawful.

4.72 With regard to champerty, Lord Justice Millett referred to the House of Lords decision in *Giles v Thompson*[79] in which Lord Mustill observed that "*For champerty there must be added the notion of a division of the spoils*."

4.73 Champerty was described as "*a particularly obnoxious form*" of maintenance by Lord Denning MR in *Trendtex Trading Corporation v Credit Suisse.*[80] He added that:

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75 [1908] 1 KB 1006, at 1014.
76 [1994] 1 AC 142, at 161.
77 [1919] AC 368, at 389.
78 [1996] 1 WLR 763.
79 [1994] 1 AC 142.
80 [1980] QB 629, at 654.

> *"[Champerty] exists when the maintainer seeks to make a profit out of another man's action – by taking the proceeds of it, or a part of them, for himself. Modern public policy condemns champerty in a lawyer whenever he seeks to recover – not only his proper costs – but also a portion of the damages for himself: or when he conducts a case on the basis that he is to be paid if he wins but not if he loses." [Emphasis added by Millett LJ]*

Lord Justice Millett conceded that a contingency fee which entitled the solicitor to a reward over and above his ordinary profit costs if he won should be condemned as tending to corrupt the administration of justice. He saw no reason to suppose, however, that Lord Denning had in mind a contingency fee which entitled the solicitor to no more than his ordinary profit costs if he won.

Changing public policy

4.74 Having explained that the public policy underlying the two doctrines was different, Lord Justice Millett said that public policy was not static, and had narrowed progressively in scope in recent times. If a solicitor agreed to charge no more than his ordinary profit costs if he won, and nothing if he lost, the arrangement did not involve a "*division of the spoils*." Lord Justice Millett said that he would regard the solicitor "*not as charging a fee if he wins, but rather as agreeing to forgo his fee if he loses. I question whether this should be regarded as contrary to public policy today, if indeed it ever was*."[81]

4.75 Lord Justice Millett said that if the law had been correctly stated in *Aratra Potato Co Ltd* "*then something has gone badly wrong.*"[82] It was time to step back and consider matters anew in the light of modern conditions. Lord Justice Millett started his re-examination with three propositions:

> *"First, if it is contrary to public policy for a lawyer to have a financial interest in the outcome of a suit, this is because (and only because) of the temptations to which it exposes him. At best he may lose his professional objectivity; at worst he may be persuaded to attempt to pervert the course of justice. Secondly, there is nothing improper in a lawyer acting in a case for a meritorious client who to his knowledge cannot afford to pay his costs if the case is lost: … Not only is this not improper; it is in accordance with current notions of the public interest that he should do so. Thirdly, if the temptation to win at all costs is present at all, it is present whether or not the lawyer has formally waived his fees if he loses. It arises from his knowledge that in practice he will not be paid unless he wins. In my judgment the reasoning in British Waterways Board v Norman … is unsound."*[83]

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81 At page 788.
82 At page 789
83 At page 789.

4.76 Lord Justice Millett added that:

> *"… it is in my judgment fanciful to suppose that a solicitor will be tempted to compromise his professional integrity because he will be unable to recover his ordinary profit costs in a small case if the case is lost. Solicitors are accustomed to withstand far greater incentives to impropriety than this. The solicitor who acts for a multinational company in a heavy commercial action knows that if he loses the case his client may take his business elsewhere …*
>
> *Current attitudes to these questions are exemplified by the passage into law of the Courts and Legal Services Act 1990. This shows that the fear that lawyers may be tempted by having a financial incentive in the outcome of litigation to act improperly is exaggerated, and that there is a countervailing public policy in making justice readily accessible to persons of modest means. Legislation was needed to authorise the increase in the lawyer's reward over and above his ordinary profit costs. It by no means follows that it was needed to legitimise the long-standing practice of solicitors to act for meritorious clients without means, and it is in the public interest that they should continue to do so."*

Absence of implied contract as to costs

4.77 Mrs Taylor deposed in an affidavit that:

> *"There was no agreement either expressly or by implication between myself and my husband, acting as my solicitor, that he would not render bills to me. Upon the recovery of costs awarded to me they will be dealt with in the same way as with any client recovering costs following litigation and a bill will be raised covering these costs."*[84]

4.78 Lord Justice Millett doubted the Divisional Court's findings in *British Waterways Board v Norman*[85] that, under such circumstances, the only possible conclusion from those facts was that there was an understanding amounting in law to a contract that the client would not be liable for the solicitor's costs if she lost the case.[86]

4.79 Lord Justice Millett said that:

> *"In my opinion the facts did not warrant the inference that there was any understanding as to Mrs Taylor's legal liability in respect of costs. To my mind the only legitimate inference was that, while Mrs Taylor's legal liability for costs was not affected, save*

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84 At page 784.
85 (1993) 26 HLR 232.
86 At page 788.

> *in unforeseen circumstances neither party expected Mr Taylor to demand payment or enforce her liability unless she won her case and to the extent that she recovered costs from the plaintiffs."*[87]

Hence, the indemnity principle as established in *Gundry v Sainsbury*[88] would not avail Thai Trading Co.[89]

Conclusion

4.80 Lord Justice Millett concluded that there was nothing unlawful in a solicitor acting for a party to litigation agreeing to forgo all or part of his fee if he lost, provided that he did not seek to recover more than his ordinary profit costs and disbursements if he won. The decision was given in February 1998 and leave to appeal to the House of Lords was refused.

Bevan Ashford v Yeandle Ltd[90]

4.81 This case was decided by the Divisional Court after *Thai Trading Co*. In this case, the solicitors entered into a conditional fee agreement with the client providing for the payment of the plaintiff's normal profit costs if they succeeded in the arbitration proceedings, and nothing except disbursements if they lost. However, unlike *Thai Trading Co*, the solicitors subsequently entered into a contingency fee agreement with counsel which provided that should the proceedings fail counsel would receive nothing but, if successful, would be paid an uplift of 50% above his normal fee. The solicitors applied to the court for a declaration that the conditional fee agreements were not unenforceable on grounds of champerty or otherwise illegal.

4.82 Applying the principles in *Thai Trading Co*, Sir Richard Scott, Vice Chancellor, granted the declaration to the solicitors and held that, since arbitration proceedings are not "*proceedings in court*" within the meaning of sections 58 and 119 of the Courts and Legal Services Act 1990, the contingency fee agreements in question were not expressly authorised by section 58 of the 1990 Act. Although the common law of champerty was applicable, the effect of section 58 of the 1990 Act and its associated regulations was to remove any public policy objection to a contingency fee agreement relating to an arbitration which complied with those provisions and which would be sanctioned by them if made in relation to court proceedings. Hence, the court held that both agreements did so comply and neither was void for champerty or otherwise illegal on public policy grounds.

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87 At 784-785.
88 [1910] 1 KB 645. See earlier discussion.
89 At 784.
90 [1998] 3 All ER 238.

Post *Thai Trading Co* and *Bevan Ashford* decisions

4.83 Zander has observed[91] that the common law seemed at that time to have changed after these decisions, and both the Bar Council and the Law Society amended their rules accordingly. The Code of Conduct issued by the General Council of the Bar was amended in July 1998 to the effect that a barrister may charge "*on any basis or by any method he thinks fit provided that such basis or method is (a) permitted by law; and (b) does not involve the payment of a wage or salary*."[92] The Guidance to the Code of Conduct explains that the new rule would permit at least the following arrangements: (a) "no win, no fee" (where the barrister agreed to forego the whole of his fee if the case is lost); (b) "no win, reduced fee" (where the barrister forfeits part of his fee if the case is lost); and (c) some conditional fee agreements outside the statutory scheme.[93]

4.84 The Law Society also amended its rules, and the new Practice Rule 8(1) adopted in February 1999 states that a solicitor may not enter into a contingency fee arrangement "*save one permitted under statute or by the common law*". However, what was permitted by the common law was volatile and unclear.

4.85 On 1 April 2000, the provisions of the Access to Justice Act 1999 came into force. The Act gives statutory effect to the judgment in *Thai Trading Co v Taylor*, and section 27 permits the recovery of costs under a conditional fee agreement, including one providing for a success fee. Family proceedings and criminal proceedings cannot be the subject of an enforceable conditional fee agreement, but a new section 58A(1)(a) of the Courts and Legal Services Act 1990[94] specifically allows conditional fee agreements under section 82 of the Environmental Protection Act 1990, so taking account of those in the position of Mrs Norman in the *British Waterways* case.

Cases not following *Thai Trading Co*

Hughes v Kingston-upon-Hull City Council[95]

4.86 Even before the major decision of the Court of Appeal in *Awwad v Geraghty & Co* discussed below*,* some doubts were cast on *Thai Trading Co* The Divisional Court in *Hughes v Kingston upon Hull City Council* decided that it was not bound by *Thai Trading Co* because the judges in that case had not been referred to the binding authority of the House of Lords in *Swain v Law Society.*[96] In *Swain*, the House of Lords held that the Law Society's Practice Rules had the force of law. Hence, the Divisional Court came to the

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91 Zander, "Will the Revolution in the Funding of Civil Litigation in England Eventually Lead to Contingency Fees?" (2002), 52 De Paul L Rev 259.

92 Para 308.

93 The relevant Guidance has been fully revised in January 2001 and named the Conditional Fee Guidance.

94 Added by section 27 of the Access to Justice Act 1999.

95 [1999] QB 1193.

96 [1983] 1 AC 598.

conclusion that when Lord Justice Millett stated that "*the fact that a professional rule prohibits a particular practice does not of itself make the practice contrary to law*" he had erred in law. The Divisional Court did not address any of the public policy issues but decided the case solely on the basis of the Practice Rules.[97]

Awwad v Geraghty & Co

4.87 The Court of Appeal, in *Awwad v Geraghty & Co,*[98] has restated the common law condemnation of contingency and conditional fee agreements to fund legal proceedings as being champertous, contrary to the public interest, and, hence, unlawful and unenforceable, unless expressly authorised by statute. The earlier Court of Appeal decision in *Thai Trading Co v Taylor*,[99] that there were no longer public policy grounds to prevent lawyers agreeing to work for less than their normal fees in the event that they were unsuccessful, has thus been reversed.

4.88 In *Awwad,* the solicitors agreed in 1993 (before conditional fee agreements were allowed) to act for Mr Awwad in a libel case and entered into an oral contract to act at their usual hourly rate if the proceedings were successful and at a reduced rate if unsuccessful. The proceedings were concluded by Mr Awwad's acceptance of a payment into court. Mr Awwad declined to pay Geraghty & Co.'s bill on the grounds that the conditional fee agreement was unenforceable. The conditional fee agreement in question did not satisfy the requirements of the applicable orders and rules. The question, therefore, was whether the agreement was unlawful at common law, or, in other words, whether public policy prohibited the recovery of conditional normal fees.

4.89 Lord Justice Schiemann, in giving the leading judgment, said:

> *"I share Lord Scarman's reluctance to develop the common law at a time when Parliament was in the process of addressing those very problems. It is clear from the careful formulation of the statutes and regulations that Parliament did not wish to abandon regulation altogether and wished to move forward gradually. I see no reason to suppose that Parliament foresaw significant parallel judicial developments of the law."*[100]

4.90 Lord Justice May concurred and added:

> *"… In so far as public policy might enter the present debate, I agree with Schiemann LJ's conclusion. … In my judgment, where Parliament has, by what are now (with section 27 of the Access to Justice Act 1999) successive enactments, modified*

97 The decision was later applied in *Leeds City Council v Carr The Times*, 12 November 1999.
98 [2000] 3 WLR 1041, [2000] 1 All ER 608.
99 [1998] QB 781.
100 At 1061.

the law by which any arrangement to receive a contingency fee was impermissible, there is no present room for the court, by an application of what is perceived to be public policy, to go beyond that which Parliament has provided. …"[101]

4.91 Permission to appeal to the House of Lords was given, but in the event no appeal was taken. The present position is, therefore, that in contentious proceedings no contingency fee arrangement is permissible at all, and no conditional fee arrangement is permissible, even if there is no success fee, unless it complies with the relevant primary and secondary legislation.[102] Fees are not recoverable under any non-compliant agreement, and any claim for payment based on *quantum meruit* would fail if a court refuses to enforce an agreement for reasons of public policy.

Claims intermediaries

English v Clipson

4.92 The August 2002 decision of the County Court in *English v Clipson*[103] has serious implications for claims intermediaries, which have been operating conditional fee agreements on a "mass production" scale for a number of years. The County Court ruled that the conditional fee agreements used by TAG ("The Accident Group") were unenforceable and the insurance premiums irrecoverable. An appeal was originally scheduled to be heard at the end of October 2002 but it now appears that the appeal has not been proceeded with.

4.93 It may be useful at this stage to set out some of the factual background of this case, as it sheds light on the conditional fee scenario in England.

4.94 The County Court decision pointed out that in recent years a number of corporate organisations had grown up whose business it was to provide a one-stop claims service. These were the claims management companies, one of which was TAG. TAG canvasses potential customers via the Internet, and in the High Street by means of mobile stands. TAG's website advertises its service as one which helps the victims of accidents to "*pursue claims for compensation and manages the entire claim from first call through to final settlement.*" TAG will only accept and manage claims having a damages value in excess of £1,500 and which are assessed to have a greater than 50% chance of success. TAG presumably provides a valuable service for its customers and appears commercially successful.

4.95 In a number of respects, however, defendants' liability insurers, who more often than not pick up the costs bill of the successful claimant, have become concerned at the level of certain elements of those costs, particularly

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101 At 1068.

102 Bar Council, Conditional Fees Guidance, at 10.

103 Claim No : PE 104264.

in relatively low value claims. They contend that the costs payable are disproportionate to the amount of damages and that these costs reflect ancillary services provided by the claims management company which have no, or only passing, relevance to the litigation. Elements of those costs which have caused concern and, of late, have been the subject of judicial scrutiny, both as to enforceability and amount, are the success fee and the ATE premium, as in *Callery v Gray* which has been discussed earlier in this chapter.

4.96 The workings of the TAG scheme for a typical small value personal injury claim are as follows:

(1) The potential claimant completes a TAG application form (detailing the circumstances of the accident, the third party, injuries, etc), and a service agreement/declaration form. This document contains what appears to be a detailed explanation of the scheme and appears also to constitute a proposal for the ATE insurance policy.

(2) If the claim is accepted, a confirmation letter is sent to the claimant. It is at this point that he becomes an insured under the block Legal Protection policy, subject always to later payment of the premium.

(3) The case is then passed to TAG's associated company, Accident Investigations Limited (AIL), whereupon an AIL employee will contact the claimant to complete a detailed questionnaire. AIL then returns the file to TAG with its recommendations on both liability and quantum.

(4) If the case has TAG's continued support, the complete file is then passed to their vetting solicitors, Rowe and Cohen, whose task it is to assess whether the case has a better than 50% chance of success and a potential value exceeding £1,500.

(5) If Rowe and Cohen "approve" the claim, they will then send the case / file to a firm of panel solicitors. That firm has the ensuing 48 hours in which to accept or reject the referral. If they accept, this is subject always to the claimant's formal instructions as client of that firm.

(6) If the panel solicitor accepts the referral, he must then send to the claimant a conditional fee agreement and a client care letter, which fulfils the requirements of rule 15 of the Solicitors' Practice Rules. In fact, the conditional fee agreement is constituted by reading together the client care letter and its attached written "terms and conditions". At the same time, the panel solicitor sends a copy of those documents to TAG. The conditional fee agreement is concluded between the solicitor and the claimant / client by the latter returning, in due course, to the former a signed

copy of the client care letter, although this part of the procedure seems to conflict with what immediately follows.

(7) TAG then instructs AIL to have one of its employees contact the claimant and arrange a home visit. The AIL employee's task is to (a) explain the conditional fee agreement to the claimant, (b) obtain the claimant's signature on a document entitled "Fact Find and Oral Advice Sheet", and (c) explain to him, and obtain his signature on, the finance agreement by which the claimant borrows the ATE policy premium from the nominated finance provider. This is currently First National Bank Plc.

4.97 The County Court held that the duties of the legal representative could not be delegated and the requirements of the Conditional Fee Agreements Regulations 2000 had not been satisfied. Hence, the court ruled that the conditional fee agreement was not enforceable between the solicitor and the claimant, Mr English, with the result that the claimant had no right to an indemnity for costs from the defendant, Mr Clipson.

4.98 The Conditional Fee Agreements Regulations 2000 require that certain information must be given to the client by the legal representative before a conditional fee agreement is made. The legal representative must provide his client with such further explanation, advice or information about the specified matters as the client may reasonably require. The specified matters are:

(a) the circumstances in which the client may be liable to pay the costs of the legal representative in accordance with the agreement;
(b) the circumstances in which the client may seek assessment of the fees and expenses of the legal representative, and the procedure for doing so;
(c) whether the legal representative considers that the client's risk of incurring liability for costs in respect of the proceedings to which the agreement relates is insured against under an existing contract of insurance;
(d) whether other methods of financing those costs are available, and, if so, how they apply to the client and the proceedings in question; and
(e) whether the legal representative considers that any particular method, or methods, of financing any or all of those costs is appropriate and, if he considers that a contract of insurance is appropriate or recommends a particular such contract:

(i) his reasons for doing so, and
(ii) whether he has an interest in doing so.

4.99 Before a conditional fee agreement is made the legal representative must explain its effect to the client. The information which the legal representative is required to give about items (a) to (d) must be given

orally (whether or not it is also given in writing), but information required to be given about item (e), and the explanation as to the effect of the conditional fee agreement, must be given both orally and in writing.

The scope of application of section 58 of the Court and Legal Services Act 1990

R (Factortame Ltd) v Secretary of State for Transport, Local Government and the Regions (No 8)

4.100 This case[104] concerned a firm of chartered accountants, Grant Thornton, which agreed to provide services ancillary to litigation in return for 8% of the final settlement received.[105] On a preliminary issue as to the claimants' entitlement to costs, the Master held that Grant Thornton's contingency fee agreements were not champertous and the claimants could recover the 8% from the Secretary of State.

4.101 The Court of Appeal dismissed the Secretary of State's appeal because they found that Grant Thornton had not acted as expert witnesses but had retained entirely independent experts; that the 8% was not extravagant and was likely to operate as a cap on the fees; that no reasonable onlooker would seriously have suspected that Grant Thornton, who were reputable members of a respectable profession subject to regulation, would be tempted by their financial interest in the outcome of the proceedings to deviate from performing their duties in an honest manner; and having regard to the fact that the agreements ensured access to justice, public policy was not affronted by the agreements and the Master was correct in concluding that they were not champertous.

4.102 In relation to the position of expert witnesses acting under an event-triggered fees arrangement, the Court of Appeal expressed its views as follows:

> *"Clearly, Chadwick LJ did not contemplate any legal bar to experts providing their services on a conditional fee basis and it is correct that such a course can assist access to justice. But the expert will often be in a position to influence the course of the litigation in a manner in which the funder, or even the lawyer conducting the litigation, will not.*
>
> *To give evidence on a contingency fee basis gives an expert, who would otherwise be independent, a significant financial interest in the outcome of the case. As a general proposition, such an interest is highly undesirable. In many cases the expert will be giving an authoritative opinion on issues that are critical to*

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104 [2002] 3 WLR 1104.

105 The agreement was a contingency fee, not conditional fee, agreement as defined in the Preface of this paper.

the outcome of the case. In such a situation the threat to his objectivity posed by a contingency fee agreement may carry greater dangers to the administration of justice than would the interest of an advocate or solicitor acting under a similar agreement. Accordingly, we consider that it will be in a very rare case indeed that the court will be prepared to consent to an expert being instructed under a contingency fee agreement.

In the present case Grant Thornton did not perform the role of expert witnesses. They were careful to retain for that purpose experts who were entirely independent. …"

4.103 The Court of Appeal held that section 58 of the Courts and Legal Services Act 1990, both in its original form and as subsequently amended by the Access to Justice Act 1999, applied only to agreements for the provision of litigation or advocacy services, and did not apply to contingency fee agreements such as those entered into by Grant Thornton, or by expert witnesses for the provision of services ancillary to litigation. The court therefore had to look at the facts of the particular case and consider whether those facts suggested that the agreement in question might tempt the allegedly champertous maintainer for his personal gain to inflate the damages, to suppress evidence, to suborn witnesses or otherwise to undermine the ends of justice.[106] In other words, the court had to ask whether the agreement tended to conflict with existing public policy directed to protecting the due administration of justice with particular regard to the interests of the defendant.[107] The court also added that the legislation had evidenced a radical shift in the attitude of public policy, and conditional fees had been permitted in order to give effect to another facet of public policy – the desirability of access to justice.[108]

Hollins v Russell

4.104 The Court of Appeal decision in *Hollins v Russell*[109] contains the rulings in six test cases, namely *Sharratt v London Central Bus Co Ltd and other appeals (The Accident Group Test Cases), Hollins v Russell, Tichband v Hurdman, Dunn v Ward, Pratt v Bull,* and *Worth v McKenna*. The appeals raised three distinct issues:

(i) the circumstances in which a receiving party must either disclose its conditional fee agreement to the paying party or endeavour to prove its claim by other means – *Pratt v Bull*, *Worth v McKenna*;

(ii) whether any costs and disbursements are recoverable from a paying party in the event of non-compliance with the Conditional Fee Agreements Regulations 2000 – all six cases;

106 At para 36.
107 At para 44.
108 At para 62.
109 [2003] EWCA Civ 718, [2003] 4 All ER 590.

(iii) whether, on the particular facts, the requirements in the Conditional Fee Agreements Regulations 2000 were complied with – *Hollins v Russell* (regulation 2), *Tichband v Hurdman* (regulations 2 and 3), *Pratt v Bull, Dunn v Ward and The Accident Group Test Cases* (regulation 4).

4.105 The Court of Appeal held that a conditional fee agreement would only be unenforceable due to a breach of the conditions applicable to it under section 58 of the Courts and Legal Services Act 1990 where there had been a material adverse effect either on the protection afforded to the client, or on the proper administration of justice. The court said further that "*the law does not care about very little things*" and a conditional fee agreement should only be declared unenforceable if the breach mattered and the client could have relied upon it against his solicitor. Whilst this is a valiant attempt to stop the satellite litigation where a losing defendant challenges the fine details of a conditional fee agreement in an attempt to avoid liability for costs altogether, it creates its own unfortunate uncertainty as to which requirements of the conditional fee regulations are "*very little things*" and which are not.

4.106 The court in *Hollins v Russell* also dealt with the issue of whether the paying party could compel the receiving party to disclose the conditional fee agreement and any related attendance notes. Brooke LJ summarised the correct approach as follows:

> *"So far as matters of procedure are concerned, we consider that it should become normal practice for a CFA to be disclosed for the purpose of costs proceedings in which a success fee is claimed. If the CFA contains confidential information relating to other proceedings, it may be suitably redacted before disclosure takes place. Attendance notes and other correspondence should not ordinarily be disclosed, but the judge conducting the assessment may require the disclosure of material of this kind if a genuine issue is raised. A genuine issue is one in which there is a real chance that the CFA is unenforceable as a result of failure to satisfy the applicable conditions."*[110]

Spencer v Wood[111]

4.107 This case was probably the first post-*Hollins* challenge to the enforceability of a conditional fee agreement. It was held that the conditional fee agreement was defective as the breach had had material and adverse effects on the client. The attempts to simplify the whole conditional fee agreement scheme since this case are aimed at avoiding this problem.

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110 Above, at para 220.

111 (His Honour Judge Cockcroft, Leeds District Registry, 8 July 2003, unreported).

King v Telegraph Group Ltd[112]

4.108 The facts of the case involved an article in *The Sunday Telegraph* which suggested that there were reasonable grounds to suspect Adam Musa King of terrorist offences. King sued for libel, backed by solicitors and counsel acting on a conditional fees basis. King did not take out ATE insurance and was not a man of means so that if he lost he would be unable to pay the defendant's costs. If, however, the defendant lost, they would have to pay him damages, and his costs plus a 100% success fee. It was a "lose/lose" situation for the defendant whose own legal fees amounted to around £400,000. The case touched on two important issues: how to impose sensible limits on costs that were recoverable from the defendants in conditional fee cases even when those cases were settled; and the effect on freedom of speech.

4.109 The defendants applied to the court to either strike out the case as an abuse of process, or to order the claimant to make a modest payment into court, or to cap the costs recoverable by the claimant. The court rejected the first two alternatives but recommended that in future such cases should have a cap on costs at the allocation stage.

4.110 The Court of Appeal was strongly critical of certain aspects of the claimant's solicitors' conduct as to costs, saying that there were "*none of the usual constraints which tend to encourage a party's solicitors to advance their client's claim in a reasonable and proportionate manner*".

4.111 The Court of Appeal found that:

- *"There are three main weapons available to a party who is concerned about extravagant conduct by the other side, or the risk of such extravagance. The first is a prospective costs capping order of the type I have discussed in this judgment. The second is a retrospective assessment of costs conducted toughly in accordance with CPR principles. The third is a wasted costs order against the other party's lawyers, but this is not the time or place to discuss the occasions when that would be the appropriate weapon." [para 105]*

- *"In my judgment, recourse to the first of these weapons should be the court's first response when a concern is raised by defendants of the type to which this part of this judgment is addressed. The service of an over-heavy estimate of costs with the response to the allocation questionnaire may well trigger off the need for such a step to be taken in future." [para 106]*

[112] [2004] EWCA Civ 613. Hearing date 18 May 2004.

- *"What is in issue in this case, however, is the appropriateness of arrangements whereby a defendant publisher will be required to pay up to twice the reasonable and proportionate costs of the claimant if he loses or concedes liability, and will almost certainly have to bear his own costs (estimated in this case to be about £400,000) if he wins. The obvious unfairness of such a system is bound to have the chilling effect on a newspaper exercising its right to freedom of expression … and to lead to the danger of self imposed restraints on publication which he so much feared." [para 99]*

- *"The only way to square the circle is to say that when making any costs capping order the court should prescribe a total amount of recoverable costs which will be inclusive, so far as a CFA-funded party is concerned, of any additional liability. It cannot be just to submit defendants in these cases, where their right to freedom of expression is at stake, to a costs regime where the costs they will have to pay if they lose are neither reasonable nor proportionate and they have no reasonable prospect of recovering their reasonable and proportionate costs if they win". [para 101]*

Atack v Lee **and** ***Ellerton v Harris***[113]

4.112 These were two simple road traffic accident cases which occurred before 5 October 2003. The Court of Appeal clarified that these cases were not governed by the Civil Justice Council's fixed success fee of 12.5% for claims worth less than £15,000 that settle before trial. The fixed rate of 12.5% was not appropriate because the new approach did not take into account the individual facts of each particular case.

4.113 The Court of Appeal was also aware of "*some lingering uncertainty about the combined effect of Callery v Gray and Halloran v Delaney"* and clarified that for cases governed by the old regime, the reasonableness of the success fee has to be assessed as at the time the conditional fee agreement was agreed. A two-stage success fee was to be encouraged:

> *"In other words, the success fee may be a higher percentage (up to 100% in an appropriate case) in the event that a claim does not settle within the protocol period, and a lower success fee (down to 5% in the very simplest of cases) in claims which do settle within that period."*[114]

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113 [2004] EWCA Civ 1712, 16 December 2004.

114 Per Lord Justice Brooke.

Summary of main issues

4.114 While there has been much judicial consideration of various aspects of conditional fees, there remains considerable uncertainty as to the position in respect of a number of important issues. There appears, for instance, to be some consensus that a two-stage success fee should be adopted, with a lower fee charged if a case settles at an early stage, but courts have the difficult task of determining what constitutes a reasonable level of success fee.[115] Most problematic, it seems, are the ATE premiums, both as to the appropriate time to take out this insurance ("the prematurity issue")[116] and, more so, the appropriate amount of ATE premiums ("the reasonableness issue").[117]

4.115 A further difficulty arises where there is a pre-existing BTE insurance. There may then be a dispute as to whether the claimant should have relied on the defendant's BTE insurance instead of taking out his own ATE insurance.[118] The decision turns on whether the pre-existing BTE cover is "satisfactory" for a claim of that particular size.

4.116 The Court of Appeal tried to contain the uncertainties surrounding conditional fee agreements in *Hollins v Russell* by clarifying that only "material" breaches of the requirements would render a conditional fee agreement unenforceable. However, this is unlikely to be the end of satellite litigation because whether a breach is "material" or not is open to interpretation.

4.117 There has also been a sharp divergence of view as to what constitutes public policy in this area, and which types of conditional fee arrangements comply with that fluid concept.[119] Given the decision in *Awwad v Geraghty & Co,* the position now is that, in contentious proceedings, no conditional fee arrangement is permissible, even if there is no success fee, unless it complies fully with the relevant primary and secondary legislation. Hence, it is not only claimants who are trying to find flaws in conditional fee agreements; defendants' solicitors are also looking for flaws so that the defendant can avoid paying the claimants' legal costs under the indemnity rule. It should be noted that permission to appeal to the House of Lords was given, though no appeal was made.

4.118 In addition to these problems, issues posed by the operation of claims intermediaries have attracted litigation.[120]

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115 See *Callery v Gray*, *Halloran v Delaney*, *Sarwar v Alam,* cited above.

116 See Lord Scott's dictum in *Callery v Gray* cited above and also *Claims Direct Test Cases*, cited above.

117 See Lord Hoffmann's dictum in *Callery v Gray*, cited above and also *Sarwar v Alam and Claims Direct Test Cases*.

118 See *Sarwar v Alam*, cited above.

119 See *British Waterways Board v Norman, Thai Trading Co v Taylor, Awwad v Geraghty & Co,* all cited above.

120 See *English v Clipson*, cited above.

4.119 The conditional fee regime is not without problems. Lord Phillips MR[121] commented that:

> *"The abolition of legal aid for personal injury claims and its replacement by conditional fee agreements incorporating uplift for success and after the event insurance, both chargeable to the unsuccessful defendant, has had unforeseen and very unfortunate consequences. Put bluntly, defence interests felt that they were being ripped off by being called upon to pay uplift and substantial insurance premiums in relation to the vast proportion of claims which were almost bound to be settled before they ever got to court. The result was warfare between claimant and defence interests – warfare which was assisted by the introduction into the rules of court of costs only proceedings so that defendants could settle liability but take the costs to litigation. … In the meantime, large numbers of solicitors doing small claims work were not being paid and the courts were log-jammed with costs-only proceedings, many on hold awaiting the result of test cases. I consider that this was the greatest problem facing the civil justice system when I took over as Master of the Rolls."*

4.120 Conditional fees have certainly come under criticism since their introduction in 1995. As well as the issues highlighted above, the simple fact that a losing defendant is liable to pay not only the plaintiff's taxed costs, but also the success fee of the plaintiff's solicitors and the relevant insurance premium, has caused much controversy and satellite litigation. Defendants still consider it unfair that these extra costs can be incurred at the outset, before they have been given an opportunity to settle an obvious claim.[122] It remains in the interests of the losing defendant to challenge the uplift on taxation, or by costs only proceedings, and as a result the courts have found themselves in the position of cutting back significantly on the success fee agreed and approved by the plaintiff's solicitors and the plaintiff. For some time this caused plaintiffs' solicitors difficulties, since the fees charged by a conditional fee practice are calculated on the assumption that the success fees in winning cases will outweigh those instances where a case is lost and the firm recovers nothing. The court's intervention in that process has caused problems, but it is fair to say that the passage of time and experience has led to the standardisation of success fees, which are less often reduced by the Court on taxation.

4.121 Nevertheless, it remains open to the losing defendant to challenge the conditional fee agreement on the basis that the detailed technicalities of the regulations have not been complied with. In some cases, the conditional fee agreement was held invalid by the Court on the basis, for example, that the arrangement had been explained by the plaintiff's solicitor to the plaintiff in writing, but not also orally, as required by the regulations. The effect was not only that the defendant escaped all liability for costs, but also

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121 Keynote Speech at the Law Society Litigation Conferences, June 2003.

122 Following *Callery v Gray*, (Nos 1 and 2) [2002] 1 WLR 2000-2032.

that the successful plaintiff's solicitor received nothing. As explained in this and the previous chapter, significant effort has been devoted to simplifying and streamlining this process, to avoid these difficulties, including in particular the Court of Appeal decision in *Hollins v Russell*,[123] which held that minor errors in the conditional fee agreement will not render it void. Together with the announced plan to revoke the Conditional Fee Agreements Regulations[124], it is believed that these combined measures will considerably simplify the regulations governing conditional fee agreements, making them simpler and less costly for the solicitor to draw up, as well as for the client to understand. This should also reduce the amount of satellite litigation, in which the losing party challenges the conditional fee agreement in the hope of avoiding liability for costs altogether. Nevertheless, the fact that the losing party must pay the success fee, together with the insurance premium, remains a source of much contention and public policy debate.

4.122 The insurance industry reacted positively to the introduction of conditional fees, and a number of ATE companies have sprung up. In the early stages, with relatively few players in the market, business was profitable, and insurance premiums were low. As the business has developed, with more entrants into the market, profitability has fallen, and so insurance premiums have risen dramatically. Previously nominal in relation to the amount at stake, the ATE insurance premiums can now form a very substantial part of the costs. Although such a premium might eventually be recovered from a losing party, financing this premium at the outset can be difficult, with the burden often falling on the solicitor. The solution is often a complicated finance arrangement, under which the solicitor takes out a loan facility, and then draws this down to cover the ATE insurance premium and disbursements as they arise. The loan is repaid out of costs recovered from the losing party (but the solicitor pays the interest), or by an insurance payout, in the event that the case is unsuccessful, or the losing defendant cannot pay.

4.123 On a more positive note, the conclusion appears to be that access to justice has been increased, primarily in the field of personal injury, but also in other areas such as insolvency, *pro bono* and charitable work, and defamation, as well as other personal or commercial actions for parties who fall outside the shrinking scope of legal aid, but are unable to fund the litigation personally. Initial fears about unscrupulous behaviour by lawyers appear to have been unfounded, as have fears that the new arrangements would encourage "ambulance chasing". Problems with the technicalities of the conditional fee agreement regulations are well known, and are being addressed.

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123 See para 4.104 above.

124 See para 3.83 above.

Chapter 5

Event-triggered fees in other jurisdictions

Introduction

5.1 We have examined in previous chapters the operation of event-triggered fees in the United States of America and England. This Chapter provides an overview of the workings of event-triggered fees in a number of other jurisdictions.

Australian jurisdictions

5.2 Following the abolition of the offence and tort of maintenance and champerty in the United Kingdom in 1967, the Australian jurisdictions of Victoria, South Australia and New South Wales followed suit in 1969, 1992 and 1995 respectively.[1] In Queensland, although maintenance and champerty remain actionable torts,[2] they were never included as offences in the Criminal Code Act 1899 (Qld). Solicitors in Queensland are now permitted to fix their fees by an agreement which may stipulate a percentage.[3]

5.3 The Federal Court of Australia has commented that it is plainly unsatisfactory that maintenance of litigation remains a civil wrong in some states in Australia.[4] Whether there remain valid reasons for the retention of the tort at common law has not been addressed although it has long been considered obsolete. In *Clyne v New South Wales Bar Association*,[5] the High Court suggested that it may be necessary to consider whether it ought now to be so regarded. In *Halliday v High Performance Personnel Pty Ltd*,[6] Mason CJ also appears to have assumed that the status of the tort was questionable.[7]

Australian Law Reform Commission, Managing Justice – A review of the federal civil justice system 2000

5.4 A report published by the Australian Law Reform Commission[8]

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1 *Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd* [1997] 9 FCA, <www.austlii.edu.au/au/cases/cth/federal_ct/1997/9.html> (20 Jan 97) at 10 of internet version.

2 See *J C Scott Constructions v Mermaid Waters Tavern Pty Ltd* [1984] 2 Qd R 4B.

3 Per judgment in *Magic Menu Systems Pty Ltd*, cited above.

4 In *Magic Menu Systems Pty Ltd,* cited above.

5 (1960) 104 CLR 186.

6 (1993) 113 ALR 637.

7 Per judgment in *Magic Menu Systems Pty Ltd*, cited above.

8 ALRC, *Managing Justice – A review of the federal civil justice system*, 2000 Report No 89.

("the ALRC") found that it was common for lawyers to engage in conditional and speculative fee arrangements.[9] The ALRC found that the lawyers in those cases carried much of the financial risk and provided considerable low cost assistance in financing litigation.[10] The speculative and conditional fee arrangements had also assisted in promoting parties' access to the litigation process.[11]

5.5 A number of bodies have issued reports which have commented on conditional fees in Australia and these are set out by the ALRC in its Report:

- The Trade Practices Commission in 1994 recommended that lawyers should be permitted to charge an uplift to a maximum of 25%, but not a percentage of the award.[12]

- The Australian Attorney-General's Department in its *Justice Statement* of May 1995 recommended the introduction of conditional fees, except in family and criminal law cases. This should be accompanied by safeguards for clients, such as a requirement that lawyers assess the risks of winning or losing a case and provide a written assessment of these risks to clients when proposing the conditional fee arrangement.

- The Access to Justice Advisory Committee in its 1994 report recommended the introduction of conditional fees, except in family and criminal matters, and subject to safeguards, with a maximum uplift of 100%.[13]

- The ALRC in a 1988 report on group proceedings recommended conditional fees should be available for such proceedings, subject to court approval.[14]

- The Business Working Group on the Australian Legal System in its 1998 paper opposed conditional fees on the basis that they could encourage applicants to file marginal suits for their possible nuisance settlement value.[15]

5.6 The ALRC explained that all Australian jurisdictions permit lawyers to charge on a speculative fee basis to recover a fixed agreed sum if the proceedings turn out to be successful. More commonly, however, a fixed sum and a percentage uplift of the usual fee would be adopted.[16] Unlike the

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9 According to ALRC's own survey in the Federal Court, about 3% of the cases involved a speculative fee arrangement and about 13% of the cases involved a conditional fee arrangement.

10 ALRC, cited above, at 12.

11 As above. See also section 65 Australia's Supreme Court Act.

12 *Study of the Profession – Legal*, Final Report TPC, Canberra.

13 *Access to Justice – An action plan.*

14 *Grouped proceedings in the Federal Court.*

15 *Trends in the Australian legal system – avoiding a more litigious society.*

16 ALRC, cited above at para 5.21.

United States, contingency fees calculated as a percentage of the sum awarded by the court are not permitted in Australia.[17] With regard to uplift fees, the rules vary in different states of Australia:

New South Wales and Victoria

- 25% uplift fee is allowable
  (Legal Profession Act 1987)

South Australia

- 100% uplift fee is allowable
  (Profession Conduct Rules rule 8.10)

Queensland

- 50% uplift fee is allowed for barristers
  (Barristers Rules rule 102A(d))

Tasmania

- Uplift fees for barristers are expressly prohibited
  (Rules of Practice 1994 (Tas) rule 92(1))

Western Australia

- The Law Reform Commission of Western Australia described uplift fees as a "*necessary evil*" and recommended that they be allowed only with leave of the court, and the uplift fee should be calculated on the basis of the amount recovered from the other side.
  (LRCWA Report recommendations 141 – 144)

5.7 For both speculative and conditional fee arrangements, the litigant carries the risk of having to pay the costs of the other party if the claim is unsuccessful, and is also responsible for the disbursements incurred by his lawyer.[18] Some lawyers arrange litigation loans for clients from banks, usually for payment of disbursements only.

5.8 The ALRC stated that conditional fee arrangements are commonly used in money claims, including personal injury and workers' compensation matters. However, "*their implementation has not created a flood of litigation, nor is there evidence that such arrangements encourage people to pursue unmeritorious claims.*"[19] In fact, conditional fee agreements may actually work to filter out unmeritorious claims, as lawyers will not be prepared to bear the risk in such cases.

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17 As above.
18 ALRC, cited above, at para 5.23.
19 ALRC, cited above, at para 5.24.

5.9 Although conditional fee arrangements are usually made between individual litigants and their lawyers, federal legislation has been passed to legalise litigation funding schemes which are established to assist liquidators and trustees in bankruptcy in insolvency and bankruptcy matters.[20]

5.10 The ALRC noted that Justice Corporation Pty Ltd proposes to provide fees and disbursements to litigants in return for sharing a percentage of the damages awarded, without any other involvement in the case. Views are divergent about the legality of this scheme. Even for states that have abolished the old common law tort and criminal offence of maintenance and champerty, the arrangement might be considered illegal and void in contract law as being contrary to public policy.[21]

5.11 The ALRC stated its support for an extension of conditional fee schemes and litigation lending in the federal jurisdiction provided such schemes were carefully controlled to protect consumers and the administration of justice. The ALRC did not support the introduction of contingency fees based on a percentage of the amount awarded.[22]

Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd

5.12 It may be of interest to note the observations of the Federal Court in *Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd*[23] AFA Facilitation funds the costs and disbursements of litigation, in return for 20% of any compensation, award or negotiated settlement. While the court decided the case on an unrelated point of law, observations were made as to what might be considered to be contrary to public policy. The court noted that:

> *"… concerns expressed earlier this century, as to the potential for the maintenance of actions to give rise to an increase in litigation, might now be considered of lesser importance than the problems which face the ordinary litigant in funding litigation and gaining access to the courts. In the latter respect, by the time Martell v Consett Iron Co Ltd [1955] 1 Ch 363 came before Danckwerts J, his Honour was able to observe that support of legal proceedings based upon a bona fide common interest, financial or philosophical, must be permitted if the law itself was not to operate as oppressive. The Courts today, in our view, are likely to take an even wider view of what might be acceptable, particularly if procedural safeguards are present or able to be applied.*
>
> *There does not however seem to have been any detailed discussion or debate as to these matters and, relevant to this appeal, as to whether champerty will now be tolerated, and if so,*

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20 ALRC, cited above, at para 5.25.
21 ALRC, cited above, at para 5.25.
22 ALRC, cited above, at para 5.26.
23 (1997) 72 FCR 261.

on what conditions. We do not suggest that practices in the United States of America would necessarily, or even likely, be viewed as desirable. On the other hand, cases in the United Kingdom such as Grovewood Holdings PLC v James Capel & Co Ltd [1995] Ch 80 and McFarlane v EE Caledonia (No 2) [1995] 1 WLR 366 proceed upon the basis that such agreements are prima facie unlawful. In any event, this appeal does not, for reasons to which we later refer, require resolution of these larger questions."

Smits v Roach[24]

5.13 In this more recent case, a legal practitioner entered into what was effectively a contingency fee agreement: Smits Leslie would receive 10% of any amount recovered in litigation if this was less than $10 million; and 5% of any amount recovered over $10 million. The court held that the contingency fee agreement was not enforceable. As explained by the court:

- At common law, a legal practitioner could not bargain for an interest in the subject-matter of the litigation, which included seeking remuneration calculated as a proportion of the amount that may be recovered by the client in the proceedings. A legal practitioner entering into such an arrangement could not recover any fees, either under such an agreement or on a *quantum meruit* basis.

- Amendments to the Legal Profession Act 1987 (NSW) in 1993 allowed conditional costs agreements and the uplift of fees to a maximum of 25%, but provided that costs could not be determined as a proportion of, or vary in accordance with, the amount recovered in proceedings. Any provision of an agreement inconsistent with those provisions was void to the extent of the inconsistency.

- While section 6 of the Maintenance and Champerty Abolition Act 1993 (NSW) provided that maintenance and champerty were no longer crimes or civil wrongs, the common law rules relating to the enforceability of champertous agreements remained unchanged. It followed that the court's power to treat such agreements as contrary to public policy and therefore illegal and wholly unenforceable, remained unaffected by those statutory provisions.

[24] Judgment given on 19 June 2002 – Sydney, 42 ACSR 148.

The Attorney General's Department – The Justice Statement 1995

5.14 Although speculative fees are permitted in all Australian jurisdictions, it seems that only some of them allow conditional fees. The Attorney General's Department 1995 *Justice Statement* stated that conditional fees:

> *"have been permitted in South Australia and New South Wales. The Queensland Government also is committed to the introduction of [event-triggered]* [25] *fees. Consultation is underway in relation to the possible reforms of such fees".*

The paper further stated that:

> *"In the event that other State and Territory Governments do not move to permit [event-triggered]*[26] *fees, the Commonwealth is prepared to introduce uplift [conditional]*[27] *fees in federal matters. [Event-triggered]*[28] *fees would not be introduced in family or criminal law cases. The introduction of [event-triggered]*[29] *fees would be accompanied by safeguards for clients, such as a requirement that lawyers assess the risks of winning or losing a case and provide a written assessment of these risks to clients when proposing [an event- triggered]*[30] *fee arrangement."*[31]

The Law Institute of Victoria, Funding Litigation: The Contingency Fee Option, July 1989

5.15 The Law Institute of Victoria has also considered the subject and favours the introduction of conditional fees. Its proposal incorporates the following features:

- conditional fees would continue to be forbidden in criminal cases and all matrimonial matters
- all conditional fee agreements would have to be in writing
- all agreements would have to contain basic information and be set out in a standard form plain English contract prepared and made available by the Law Institute

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25 The original text uses the word "contingency", but the meaning ascribed to it corresponds with the definition of "event-triggered fees" in the Preface of this paper.

26 As above.

27 The original text uses the word "contingency" after "uplift". In this context, it has the meaning of "conditional" fees as defined in the Preface of this paper.

28 See foot-note 25 above.

29 See foot-note 25 above.

30 See foot-note 25 above.

31 Chapter 3.

- a cooling-off period of five business days would be allowed from the signing of the contract

- the Solicitors' Board would be given jurisdiction to supervise contingent fee agreements. It would have power to vary or set aside any contingent fee agreement that was unreasonable, or if the amount to be paid under the agreement was unconscionable

- a maximum percentage fee would not be set

- party/party costs would remain the property of the client unless the parties specifically agreed otherwise

- liability for, and payment of, disbursements should be a matter of contract between the parties.

Legal Practice Act 1996, Victoria

5.16 Division 3 of Victoria's Legal Practice Act 1996 governs costs agreements. Conditional fees are allowed by virtue of sections 97 and 98 of the Act, which read:

> *"**97. Costs agreements may be conditional on success***
>
> *(1) A costs agreement may provide that the payment of some or all of the legal costs is contingent on the successful outcome of the matter to which those costs relate.*
>
> *(2) An agreement referred to in sub-section (1) is called a 'conditional costs agreement'.*
>
> *(3) A conditional costs agreement may relate to proceedings in any court or tribunal, except criminal proceedings or proceedings under the Family Law Act 1975 of the Commonwealth.*
>
> *(4) A conditional costs agreement –*
> *(a) must set out the circumstances that constitute a successful outcome of the matter; and*
> *(b) may exclude disbursements from the legal costs that are payable only on the successful outcome of the matter.*
>
> *(5) A legal practitioner or firm must not enter into a conditional costs agreement unless the practitioner or a partner of the firm has a reasonable belief that*

a successful outcome of the matter is reasonably likely.

98. Uplifted fees are allowed

(1) A conditional costs agreement may provide for the payment of a premium on the legal costs otherwise payable under the agreement on the successful outcome of the matter in respect of which the agreement is made.

(2) The premium must be a specified percentage of the legal costs otherwise payable, and must be separately identified in the agreement.

(3) A legal practitioner or firm must not enter into a conditional costs agreement under which a premium, other than a specified percentage not exceeding 25% of the costs otherwise payable, is payable on the successful outcome of any matter involving litigation."

5.17 Section 99(1) of the Act contains an express prohibition of contingency fees:

> *"A legal practitioner or firm must not enter into a costs agreement under which the amount payable to the legal practitioner or firm under the agreement, or any part of that amount, is calculated by reference to the amount of the award or settlement or the value of any property that may be recovered in any proceedings to which the agreement relates."*

5.18 A legal practitioner or firm that has entered into a costs agreement in contravention of section 97(5), 98(3) or 99(1) is not entitled to recover any amount in respect of the provision of legal services in the matter, and must repay any amount received.[32] The client will be entitled to recover the amount from the practitioner or firm as a debt if it is not repaid.[33]

5.19 Other relevant provisions include:

- A costs agreement must be written or evidenced in writing, and may consist of a written offer that is accepted in writing or by other conduct.[34]
- If the costs agreement is not fair and reasonable or if the client was induced to enter into the agreement by fraud or

[32] Section 102(3).
[33] Section 102(4).
[34] Section 96(2), (3).

misrepresentation, then the client may apply to a tribunal to cancel the costs agreement.[35]

Comments of the Law Institute of Victoria

5.20 In September 1999, the President of the Law Institute of Victoria, Mr Michael Gawler, referred to reports in the media that the courts were being swamped with new civil actions and that Australia was becoming a more litigious society. The Law Institute pointed out that the number of cases before the courts had actually declined.[36] Mr Gawler said it was important to distinguish between the myth and the reality of civil litigation, and that a huge majority of Australians were still unable to use the court system because they could neither afford lawyers' fees nor obtain legal aid.

5.21 Mr Gawler commented that the 25% uplift on fees permitted by section 98(3) of the Legal Practice Act 1996 constituted too little incentive for lawyers. He contended that if lawyers were allowed to charge a suitable premium on normal fees in cases conducted on a success fee basis, then that change would allow most people to access the courts.

5.22 Mr Gawler called for the implementation of a contingency fee arrangement whereby lawyers could be paid up to 33% of the damages recovered. That would allow people who had no other way to take their claim to court to do so. Mr Gawler said he was aware that doctors and others opposed the introduction of contingency fees on the grounds that this would lead to a litigation explosion against professionals, and inflated damages. Mr Gawler believed that these allegations were not logical because: first, lawyers would not be prepared to take on cases on a contingency fee basis unless they thought they could win; and, second, plaintiffs would still face the risk of paying the defendant's costs if they lost.

Legal Profession Act 1987, New South Wales

5.23 Part 11 Division 3 of the New South Wales' Legal Profession Act 1987 deals with costs agreements. As in Victoria, conditional fees are allowed whereas contingency fees are prohibited. The relevant sections are set out below:

> ***"186 Conditional costs agreements***
>
> *(1) A barrister or solicitor may make a costs agreement under which the payment of all of the barrister's or solicitor's costs is contingent on the successful outcome of the matter in which the barrister or solicitor provides the legal services.*

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35 Section 103.

36 At <www.liv.asn.au/news/president/19990901.html>.

(2) Any such costs agreement is called a conditional costs agreement.

(3) A conditional costs agreement may relate to proceedings in a court or tribunal, except criminal proceedings.

(4) A conditional costs agreement must set out the circumstances constituting the successful outcome of the matter.

(5) A conditional costs agreement may exclude disbursements from the costs that are payable only on the successful outcome of the matter.

187 Payment of premium under conditional costs agreement

(1) A conditional costs agreement may provide for the payment of a premium on those costs otherwise payable under the agreement only on the successful outcome of the matter.

(2) The premium is to be a specified percentage of those costs or a specified additional amount. The premium is to be separately identified in the agreement.

(3) The premium is not to exceed 25% of those costs.

(4) However, the regulations may vary that maximum percentage of costs. Different percentages may be prescribed for different circumstances.

188 Costs not to be calculated on amount recovered in proceedings

A costs agreement may not provide that costs are to be determined as a proportion of, or are to vary according to, the amount recovered in any proceedings to which the agreement relates."

5.24 As in Victoria, any costs agreement in New South Wales should be in writing or evidenced in writing, and a costs agreement is void if it is not in writing or evidenced in writing.[37] In Victoria, the costs agreement is also void, but the legislation provides that the legal practitioner or firm may recover "*the reasonable value of the legal services provided*".[38]

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[37] Section 184(4) Legal Profession Act 1987, New South Wales.

[38] Section 93(c) Legal Practice Act 1996, Victoria.

Legal expenses insurance in Australia

5.25 The Law Reform Commission of Victoria ("the VLRC") devoted one part of its paper, *The Cost of Litigation,* to legal expenses insurance. The VLRC pointed out that legal expenses insurance might be one way of reducing the impact of legal costs on a person's decision to resolve a dispute in the court. They noted that legal expenses insurance schemes were well established in the United States and some European countries, and were growing in Canada and the United States.

5.26 Legal expenses insurance is provided in three main ways:

- as an extra benefit in policies mainly directed at other risks, such as home insurance;
- in separate policies for individual (and family) cover; and
- in group policies.

5.27 The VLRC found that in Australia, legal expenses insurance was not available incidentally to another form of cover. However, policies for both individuals and groups were becoming available, though separate policies for individuals were rare. The VLRC found that the Sun Alliance Insurance Group offered Legal Power insurance, which covered the insured and close family members living permanently with him, but it was not advertised widely and few people knew about it. The policy offers a series of options: Motor (for legal expenses arising from the use or ownership of a nominated vehicle); Personal and Consumer (other personal situations); and Combined. The cover is:

- $10,000 for one event, with a maximum of $20,000 in one year; or
- $20,000 one event, $40,000 in one year; or
- $50,000 one event, $100,000 in one year.

The premiums vary from $25 per year for motor vehicle cover for the first option to $324 for $150,000 of cover a year.

5.28 The Law Institute of Victoria investigated the feasibility of creating another commercial policy for individuals which would provide insurance cover in respect of legal expenses, other than conveyancing expenses or expenses associated with divorce and family disputes. The policies would be sponsored by lawyers' organisations. Similar attempts in the UK had proved unsuccessful. The Law Institute received detailed underwriting proposals but the scheme has not proceeded. In Western Australia, the possibility of an individual insurance has been investigated with British underwriters, but premium levels appear to be a problem. The Law Council of Australia supported legal expense insurance and suggested the Government should consider making the premiums tax deductible.

Group insurance

5.29 Legal Expenses Insurance Ltd (LEI) was incorporated in New South Wales in May 1988 and in 1989 became a specialist insurer. The shareholders in the company are the Law Foundation of New South Wales and the Government Insurance Office. The company markets legal expenses insurance throughout Australia. It has developed group insurance options to cover a variety of legal expenses, including those arising from motor vehicle actions, other civil actions, licensing matters and some minor criminal charges. Major criminal offences are not covered.

5.30 The types of group insurance offered by LEI include:

(1) *Group insurance:* an annual premium of $100 covers members and their families for up to $30,000 legal cover. They also have access to an advisory service of qualified lawyers. The insurance is available to groups of 30 or more. The scheme is specifically marketed as an employee benefit to employers, unions, social groups and small businesses.

(2) *Family Group plan:* This covers families. It is available to groups of 16 or more. The premium is dependent upon the number in the group. Seventy-five per cent enrolment is required. The policy provides a telephone advisory service, plus $30,000 in legal benefits. The family plan costs $100 per year and provides $30,000 a year in benefits to all dependent family members under 19.

(3) *Sporting Defence plan:* More akin to a traditional liability policy, this covers players, coaches, referees and club officials for legal expenses in the defence of civil or criminal actions arising directly from participation in a sporting event. The premium varies according to the numbers to be insured and the nature of the sport. The cover ranges from $8 to $20 per head for $30,000 cover.

(4) *Teachers Defence plan:* This is designed for teachers and child carers and is tailored specially for each group. It is provided either as a stand-alone, or as an addition to a family group plan.

(5) *Add-on Policy:* This is designed for purchase by financial institutions including building societies, banks and other insurers. It incorporates a telephone advisory service with $10,000 in benefits for legal expenses. Benefits are linked to the insurer's product. For example, a householder's policy can have an add-on related to family legal problems. A motor vehicle policy is linked with recovery of uninsured losses. Variations can be designed to complement the insurer's product range, including superannuation schemes and mortgage loans. The cost depends on the numbers involved but is likely to be less than $50

per policy. The add-on is available as a product which the insurer can use to reward existing customers, or which can be incorporated into the existing product for all new customers. LEI will enter into a confidentiality agreement with the insured to protect its client list.

5.31 The VLRC identified certain impediments to legal expenses insurance. These are:

- the narrow risk spread available in Australia
- the need to control adverse selection – that is, that the insurance will be taken out only by "litigious" individuals
- the need for insurers to avoid conflicts of interest.

5.32 The VLRC pointed out that the first two problems were met by the group schemes. LEI has deliberately focused on group schemes in order to increase the opportunities to spread the risk amongst the largest group of policy holders, and to avoid the risk of adverse selection. The third problem, conflicts of interest, arises where an insurance company offers legal expenses insurance to its own customers. In England, there is a European Community directive to avoid conflicts of interest between insurers and their clients. In the United Kingdom, legal expenses insurance is sold by specialist legal insurance companies because, if the insurer holds both the insurance of the primary risk and of the legal expenses, the insurer might be in a position to give legal advice to clients in matters in which it was financially involved. The European Community directive requires an insurer to have separate claims and management divisions, and prefers a separate company to underwrite the additional insurance. In the United Kingdom, four groups provide wholesale legal expenses insurance to the normal insurance industry and the wholesalers execute most of the legal work in-house. The conflict of interest in "add-on" legal expense insurance has been avoided by the Australian proposal because LEI is a separate specialist insurance company and is independent of the insurer of the primary risk.

Canadian jurisdictions

5.33 Contingency fees are widely practised in each of the Canadian provinces and territories, with the exception of Ontario. Contingency fees have become established as a non-controversial method of delivering legal services. The contingency fee has been said to be the source of few complaints from the public, and has been the subject of few challenges by clients in the courts.[39] Each of the Canadian provinces and territories has its own scheme of statutory regulation or professional self-regulation, but all have in common the widespread acceptance of contingency fees.

[39] Judd Epstein, The Key to the courthouse: the introduction of contingency fees in Victoria, December 1987, 61 Law Institute Journal 1264-1267.

Ontario

5.34 In September 1999, the Attorney General of Ontario expressed an interest in contingency fees and directed that a Ministry discussion paper on the subject be prepared in consultation with the Advocates' Society, the Canadian Bar Association (Ontario) and the Society. As a result, a Joint Committee on Contingency Fees ("the Joint Committee") was established, consisting of representatives from these organisations and Ministry staff, to carry out this task.[40]

5.35 To guide its work, in March 2000 the Joint Committee engaged Environics to conduct a public opinion survey on contingency fees. The results of the survey were as follows:

(a) Forty-six percent of respondents said that a lawyer's fee had a major impact on their decision to hire a lawyer, whereas 20% said it had little or no impact.

(b) At the beginning of the survey, 70% of respondents (after receiving an explanation of how contingency fees work) "strongly" or "somewhat" agreed that the Ontario government should allow people to hire lawyers on a contingency basis.

(c) Forty-nine percent of respondents said that they would be more supportive of contingency fees if they knew that, with contingency fees, more people might feel that they could afford the services of a lawyer for a court case.

(d) Forty-eight percent of respondents said that they would be more supportive of contingency fees if they knew that there was to be legislation that would limit the percentage of a settlement that a lawyer would be permitted to take.

(e) Forty-five percent of respondents said that they would be more supportive of contingency fees if they knew that there was to be legislation that would give clients, in the event of a dispute, the right to ask a judge to review their contingency fee arrangements.

(f) At the end of the survey, the level of support amongst respondents for contingency fees had increased to 75%.

Joint Committee's proposed regulatory scheme

5.36 The Joint Committee reached a consensus on a regulatory scheme for contingency fees. Under the Joint Committee's scheme:

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[40] Joint Committee on Contingency Fees, *Report from Society's Representative on Joint Committee on Contingency Fees* to Convocation, 23 June 2000, Ontario.

(a) Contingency fees would be permitted in litigation matters, other than in criminal law and family law proceedings.

(b) The maximum contingency fee rate would be capped at 33%.

(c) Notwithstanding the cap, a lawyer would be permitted to apply to the court, at the time of entering into a contingency fee arrangement, for approval to charge a contingency fee rate in excess of the cap. The application would be heard by a judge in chambers. It would be mandatory for the client to appear at the hearing of the application. In determining whether to grant the application, the judge would be required to consider the nature and complexity of, and the expense and risk involved in, the case.

(d) The contingency fee rate would apply to the amount recovered by the client, exclusive of any costs awarded, and exclusive of disbursements.

(e) Costs would be dealt with outside the contingency fee scheme. If costs were awarded, they would go to the client.

(f) Disbursements would be dealt with outside the contingency fee scheme. The client would be responsible for reimbursing the lawyer for all disbursements made. However, it would be open to the client to negotiate for the lawyer to assume responsibility for payment of disbursements.

(g) There would be no restrictions on who could enter into a contingency fee arrangement with a lawyer. Specifically, there would be no prohibition against minors or persons under a legal disability from entering into contingency fee arrangements.

(h) Certain standard information and terms would have to be included in every contingency fee contract. A lawyer would be prohibited from including other terms in a contingency fee contract.

(i) A client would be entitled to ask a judge to review a contingency fee contract, and any charges rendered to the client under the contract,

  (i) absolutely within one month after delivery of the lawyer's bill, and
  (ii) at the discretion of a judge, within twelve months after payment of the lawyer's bill.

(j) The regulation of contingency fees would be the responsibility of the government, implemented through amendments to the *Solicitors Act.*

5.37 Contingency fees are now allowed in Ontario. Lawyers acting on contingency fees are permitted to recover their allowed costs from the loser, and in addition, to take the full contingency fee from their own client out of damages.[41] In *Raphael Partners v Lam*,[42] the Ontario Court of Appeal upheld as reasonable and enforceable a contingency fee of 15% of the first $1 million recovered, and 10% of each additional $1 million plus any costs recovered paid by the defendant. As $2.5 million was recovered, the costs allowed were $461,000 excluding disbursements.

Ireland

5.38 Speculative fees have been in use in Ireland for over 30 years. The costs outlay in all tort actions, except for wealthy clients, are borne by the solicitor on the understanding that these will be recouped out of a successful action. Likewise, barristers will only charge for success. It is generally agreed that conditional fee arrangements have the effect of culling the frivolous or hopeless action because, if the lawyers believe it will not succeed, they will not waste time and resources on a case.

Mainland China

5.39 There does not appear to be any legislative prohibition on the charging of event-triggered fees. Hence, legal fees are a matter of contract between the lawyer and his client. There are suggestions that event-triggered fees are commonly adopted for civil litigation in Mainland China, given the limited application of legal aid. The arrangement is usually referred to as "風險代理收費制".

Northern Ireland

5.40 Northern Ireland recently conducted research on the establishment of a Contingency Legal Aid Fund ("CLAF"). It was suggested that the fund would be established with public money and be limited to certain "*standard category cases, for example, road traffic accidents*", with a high success rate so that there "*would not be a substantial drain on the fund*". It seems, however, that Northern Ireland's review does not offer sufficient protection to defendants. It was decided that the CLAF would not meet the legal costs of the winning defendant; whereas if the defendant lost, the defendant would have to pay normal costs to the claimant plus an additional levy to the CLAF.

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41 M Zander, "Will the Revolution in Funding of Civil Litigation in England Eventually Lead to Contingency Fees?" (Winter 2002), 52 De Paul L Review 259, at 15.

42 [2002] OJ No 3605, Docket No C36894, 24 September 2002.

Scotland

5.41 In Scotland, there is a long tradition of lawyers acting on a speculative basis. The speculative action is usually an action for damages for personal injury. The solicitor and the advocate undertake to act for the pursuer (plaintiff) on the basis that they will not be remunerated except in the event of success and that any costs such as court fees will be defrayed by the solicitor. The courts in Scotland have long recognised that this is a perfectly legitimate basis on which to carry on litigation and that it is a reasonable way of enabling people who do not qualify for legal aid to finance costly litigation.[43] Undertaking to act on a speculative basis imposes on both advocate and solicitor special duties to satisfy themselves that there is a reasonable prospect of success. If a solicitor wishes to instruct an advocate on a speculative basis he must state the fact explicitly in his instructions and the advocate is not bound to accept.

5.42 In the event of the case being successful the solicitor and advocate are paid their normal fee. If the case is lost they are paid nothing. Traditionally, the speculative action is useful to pursuers such as small businesses who have a reasonable case, but who are not eligible for legal aid on financial grounds. At a time when the arguments in favour of contingency fees as such were firmly rejected, the Royal Commission on Legal Services in Scotland recognised that the speculative action played an important role in Scottish law. The view was taken, however, that small businesses ought properly to obtain insurance to cover their needs as potential litigants.

5.43 An important feature of this system is that it offers no protection to the pursuer against the award of expenses in the event of an unsuccessful outcome. The rule that costs follow the event is thus not affected by a scheme such as the speculative action. The unsuccessful pursuer remains liable for the costs of his successful opponent.

South Africa

5.44 In October 1990, the Council of the Association of Law Societies ("ALS") confirmed an earlier resolution that attorneys be allowed to take cases on the basis of a "special fee arrangement". Such arrangements were to the effect that if a claim (limited to claims for damages either on the basis of contract or delict) were unsuccessful, the attorney would charge no fee, whereas if the claim were successful, he would be entitled to charge in excess of the tariff fee.[44]

5.45 Special fee arrangements were subsequently allowed in the former Transvaal on 30 March 1992. The law societies of the former provinces of the Orange Free State, the Cape and Natal were, at that time,

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[43] See *X Insurance Co v A and B* (1936), SC 239.

[44] South African Law Commission, *Report on Speculative and Contingency Fees*, November 1996.

making preparations for special fee arrangements. However, due to opposition, in 1994 the issue was referred to the South African Law Commission for further study.

5.46 In November 1996, the South African Law Commission issued its *Report on Speculative and Contingency Fees*. The Report concluded that:

> *"There appears to be a trend in jurisdictions with legal systems comparable to that of South Africa, such as England, Wales and Australia, to promote and to legalize the concept of contingency fee agreements. These countries are considered to be comparable since some of them too have divided practice systems (advocates/attorneys or barristers/solicitors), and all practice the general rule that costs follow the event (the loser in litigation pays the winner's costs) and have legal aid structures for the benefit of indigent persons. As in South Africa legal aid in the countries referred to is said to be inadequate in the sense that access to justice is facilitated only for the very poor and that especially the middle class is still left without recourse to the law. Contingency fee agreements are seen in countries abroad as a way of financing litigation, in addition to other measures such as government provided legal aid, and of opening up more avenues to achieve the Utopian situation where each and every person will be in a position to make use of the courts freely.*
>
> *In order to combat the abuse of such agreements and to conserve the lawyer/client relationship a substantial number of safeguards have either been introduced or are being considered by other jurisdictions. These include provisions as to the cap to be placed on increased fees (ranging from about 15% to 100%), the particulars that contingency fee agreements should contain, provision for cooling off periods and review of such agreements by the watchdog bodies concerned and the courts. The caps on increased fees are in some instances statutorily prescribed and in others merely regulated by the rules of the appropriate law societies.*
>
> *Criticism is levelled by other jurisdictions against the American contingency fee system which permits lawyers to take a percentage of the fruits of successful litigation. The trend seems to be rather to permit an uplift (which may be expressed as a percentage) on the normal fee on a fixed or sliding scale. It has even been suggested that the British proposals should be adopted in America as those proposals permit social reform and court access, yet discourage frivolous litigation, conflict of interests and excessive fees."*[45]

[45] South African Law Commission, cited above, at paras 2.18 – 2.20.

5.47 The South African Law Commission made a number of recommendations:

- Conditional[46] fee agreements should be legalised and the common law prohibitions on such fees should be removed.

- The Commission noted that a number of overseas jurisdictions had introduced a system of conditional fees and the Commission believed that such a system could contribute significantly to promoting access to the courts.

- Should the client win the case, the fee payable to the legal practitioner should be capable of recovery from the proceeds of the litigation (in those cases where the claim concerned was one sounding in money) and this would usually be higher than the practitioner's normal fee. This was so because the legal practitioner bore the risk of not being compensated in a number of cases.

- In view of these risks the Commission recommended that legal practitioners, in the event of successful litigation, should be entitled to receive, in addition to their normal fees for the case in question, an uplift to a maximum of 100% of their normal fees. In practice, this would mean that legal practitioners would be entitled to charge double their normal fees if they conducted their clients' cases successfully.

- An important safeguard, in the Commission's view, was that contingency fee agreements should be prohibited in family law and criminal law cases. In family law cases the concern was that the availability of conditional fee agreements might encourage litigation in, for example, the field of divorce. In respect of criminal law cases, the Commission considered that those accused of crime were adequately catered for in terms of the Constitution as far as access to justice was concerned.

- Another important safeguard recommended by the Commission was that the uplift payable to the legal practitioner in the event of success should not exceed 25% of the proceeds of the litigation in the case of claims sounding in money. This was intended to prevent all proceeds being swallowed up in legal fees.

- Both attorneys and advocates should be entitled to enter into conditional fee agreements. To enable advocates to enter into such agreements voluntarily, the Commission recommended that the restrictions in the rules of the General Council of the Bar

[46] The actual wording used by South African Law Commission is 'contingency'. However, it is evident that they meant the form of event-triggered fees defined as conditional fees in the Preface of this paper.

and in the respective rules of the individual associate and constituent Bars relating to conditional fees should be adjusted.

- In cases where an advocate was a party to the conditional fee arrangement, the total of the uplift fee portion payable to both the attorney and the advocate by the client, in claims sounding in money, should not exceed 25% of the proceeds of the action.

- It should be explained to the client that he would be liable to pay the uplift portion of the advocate's fee (in cases where counsel had to be employed) in the event of success. The basis of payment should be agreed between the attorney and his client; and the client should be advised of any other options for financing the litigation, and of their respective implications. The client should also be informed of the normal rule that he might be liable to pay the opponent's taxed party and party costs if the litigation proved unsuccessful. Finally, it should be explained to the client that there would be a cooling off period of fourteen days during which the client could cancel the conditional fee agreement.

- In view of reservations that conditional fee agreements might lead to an increase in frivolous litigation, the Commission recommended that conditional fee agreements should only be entered into in cases where there were reasonable prospects that the client's case would be successful.

- The option of conditional fee agreements should be available to all litigating parties, whether they were plaintiffs or defendants, and whether they were natural or juristic persons. Although access to justice appeared to be a particular problem for "the middle class" (ie persons too rich to qualify for legal aid but too poor to finance litigation out of their own pockets), the Commission recommended that the individual's financial means should not restrict him from entering into such agreements.

- The application of conditional fee agreements should not be limited to claims sounding in money. The controlling bodies governing the legal professions should devise guidelines with regard to the nature and form of the agreements in cases where the claim involved did not sound in money. The payment of disbursements in an action conducted on the basis of a conditional fee agreement should be a matter of contract between the lawyer and his client.

- A national disbursement fund could be established, either by Government or the controlling bodies governing the two branches of the legal profession, to assist litigants with insufficient means to pay the upfront costs of litigation, as was the approach contemplated in Australia.

Chapter 6

Arguments for and against conditional fees and related issues

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Introduction

6.1 The virtues and vices of event-triggered fee arrangements for the remuneration of lawyers in civil litigation have been a matter of debate in the legal profession for some time. The various arguments for and against such fees are discussed in turn in this chapter.

Lord Chancellor's Department's Green Paper on Contingency Fees 1989

6.2 England's move toward conditional fees was precipitated by the Lord Chancellor's Department's Green Paper on Contingency Fees 1989[1] ("the 1989 Green Paper"), which set out the main arguments both for and against event-triggered fees. Although the 1989 Green Paper uses the term "contingency fee" in its discussion of the pros and cons, it seems that the arguments apply to both contingency and conditional fees alike.

6.3 The 1989 Green Paper identified three main arguments against event-triggered fees. They were: (i) the risk of a conflict of interest,[2] (ii) the United States experience,[3] and (iii) the likelihood of an increase in litigation.[4]

(i) The risk of a conflict of interest

It can be argued that a lawyer acting on the basis of event-triggered fees has a direct interest in the outcome of the litigation. This may encourage him to behave in an unprofessional manner, such as by persuading the client to accept an early (and perhaps unnecessarily low) settlement in order to avoid the effort of fighting the case in court. The lawyer may concentrate on cases which have little merit but a high nuisance value where the defendant is more likely to be forced into making an offer to settle. The lawyer may even be tempted to try to enhance his client's chances of success by coaching witnesses, withholding inconvenient evidence, or failing to cite legal authorities which damage his client's case.

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1 Cm 571.
2 Paras 1.2, 3.1-3.3.
3 Para 3.9.
4 Para 3.10.

The 1989 Green Paper pointed out that wanting success cannot be wrong in itself, provided that unfair means are not used in achieving it. Any tendency on the part of a lawyer to improve his client's case by improper techniques ought to be capable of control through professional codes of conduct. In addition, judges have the power to penalise practitioners personally in costs for any improper act or omission in the conduct of litigation. The 1989 Green Paper found no evidence to justify the assumption that the financial interests introduced by event-triggered fees would override the normal professional standards of a lawyer in relation to his client.

(ii) The United States experience

The 1989 Green Paper pointed out that the United States experience, especially the sometimes excessively high damages and the explosion of unmeritorious litigation, was often cited as justification for maintaining the ban on event-triggered fees. Critics of contingency fees argued that the ability to sue on a contingent basis encouraged the pursuit of low merit cases for nuisance value against organisations with sizeable assets. Large organisations sometimes choose to settle even unmeritorious claims for fear of punitive damages, and the fact that legal costs could not be recovered even if they won. The increased operating costs and insurance premiums borne by those organisations were ultimately passed on to the consumer.

The 1989 Green Paper, however, found that the problems experienced in the USA could not be said to have been caused by contingency fees alone.[5] It went on to say that if event-triggered fees were introduced into England, they would not inflate the level of damages awarded by the court since that remains within the power of the judge according to well-established guidelines. It was suggested that, even if it were thought that there was a risk that judges in England would react in the same way as US juries, this could be avoided by introducing a rule that the fact that event-triggered fee arrangements were involved in the case should not be revealed until after judgment had been given. This would be similar to the existing rule regarding payment into court.

The 1989 Green Paper pointed out that a further significant difference between the United States of America and England was the absence in the former of the costs indemnity rule and the fact that costs do not follow the event. In England, the unsuccessful litigant is usually required to pay the reasonable costs of his successful opponent, and this would continue to have a deterrent effect on plaintiffs even if event-triggered fees were to be introduced.[6] Hence, the 1989 Green

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5 Other relevant features of the US civil litigation system includes jury trial for civil cases, the wide use of punitive damages, costs do not follow the event, class actions, the unique discovery process and the general nature of pleadings. See discussion in Chapter 2.

6 The 1989 Green Paper further stated that any change in the costs indemnity rule "*would certainly leave defendants unprotected, and this would not be desirable, given that it is hard to*

Paper concluded that it was unlikely that the introduction of contingency fees, taken together with the rule that costs follow the event, would have any real impact on the propensity to litigate.

(iii) Increase in litigation

Although some critics argue that contingency fees would increase the volume of litigation, the 1989 Green Paper said it was unrealistic to suppose that lawyers, as professional people running businesses, would willingly take on cases where there was little prospect of success. The solicitor acting on a contingency basis would have to make a rigorous assessment of the likely chances of success. This assessment would have to be undertaken in more detail than where the work was undertaken on a time charge basis. Hence, it was unlikely that the mere existence of contingency fees would lead to a significant upsurge in litigation.

6.4 Arguments for the introduction of event-triggered fees set out in the 1989 Green Paper were that they would: (i) enhance access to justice,[7] (ii) allow the consumer to choose,[8] and (iii) promote the effectiveness of product liability.[9]

(i) Access to justice

The main advantage of event-triggered fees was that they might give individuals and organisations who did not qualify for legal aid but who had insufficient means to finance the full cost of litigation the opportunity of bringing their claims to court.

(ii) Allowing the consumer to choose

The 1989 Green Paper stated that removing the ban on event-triggered fees would enable the client who had a cause of action to seek out the most advantageous agreement. Allowing this freedom of choice could alone be regarded as grounds for lifting the ban. Event-triggered fees would also encourage a greater level of commitment on the part of the lawyer, who would have a stake in the outcome of the proceedings. The introduction of event-triggered fees would provide clients with greater choice. Not only could the client compare the fee levels of different firms, but also the relative costs of contingency or conventional fee arrangements. This would encourage solicitors to operate efficiently.

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see how a defendant to an action for damages could benefit from the introduction of contingency fees."

7 Para 3.12.

8 Paras 3.13-3.15.

9 Paras 3.16.

(iii) Product liability

The 1989 Green Paper suggested that event-triggered fees would give an advantage to litigants in product liability cases, and would thereby make producers more conscious of their duty to supply safe products. US industry's increasing concern with product safety made European producers appear backward by comparison. That concern, however, had been fuelled by fear of adverse court judgments and awards of damages, rather than by respect for the product safety legislation or by any altruistic wish that the risk of injury to consumers should be kept to a minimum.

South African Law Commission's Report on *Speculative and Contingency Fees* 1996

6.5 Chapter 3 of the South African Law Commission's Report on *Speculative and Contingency Fees*[10] ("the SALC Report") discussed the arguments for and against event-triggered fees, and elaborated on some of the points discussed in the 1989 Green Paper. The arguments were grouped under five headings: (i) access to justice;[11] (ii) increased litigation;[12] (iii) conflict of interests;[13] (iv) excessive fees;[14] and (v) freedom of contract.[15]

(i) Access to justice

- The inherent characteristic of event-triggered fees that they facilitate access to justice was probably the most valid argument in favour of the introduction of event-triggered fees. They enabled litigants to retain a lawyer in circumstances which would otherwise, because of the cost deterrent factor, not be possible.

- Event-triggered fees shifted the risk of litigation and some of the associated costs to the lawyer, who could spread them over a number of cases.

- Increasing access to justice through event-triggered fees might increase delays in the civil litigation system because of a greater number of cases coming before the courts, but the answer to the problem should not be to prevent plaintiffs with arguable cases from instituting proceedings.

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10 Project No 93, November 1996.
11 Paras 3.2-3.4.
12 Paras 3.5-3.7.
13 Paras 3.8-3.12.
14 Paras 3.13-3.14.
15 Paras 3.15-3.17.

(ii) Increased litigation

- It was generally argued that the American contingency fee system would lead to increased litigation, to an increase in spurious, opportunistic and vexatious claims, and also to "ambulance-chasing" by lawyers.

- However, in Canada, contingency fees had not led to a huge increase in litigation. Statistics referred to by the Law Society of British Columbia showed that contingency fees had actually helped to weed out bad law-suits.

- Event-triggered fees were likely to cause lawyers to look more analytically at the merit of claims when they themselves bore some risk, than they presently did when the client bore all the risk.

- Defenders of the American contingency fees believed that the problems of over-zealous solicitation should be dealt with by the Bar's vigorous enforcement of its ethical standards, and not by the abolition of contingency fees. To abolish contingency fees because of the unethical "ambulance-chasing" behaviour of a minority of practitioners would deny legitimate claimants access to the courts.

(iii) Conflict of interest

- The financial interest of lawyers in the outcome of litigation might adversely affect their ability to give objective and disinterested advice. For example, the lawyer might advise his client to accept a low settlement offer because of the risk that he would not be able to recover any fees if the case proceeded to trial unsuccessfully.

- The lawyer's financial interest might cause him to take charge of the litigation, disregard the wishes of his client, and use his superior knowledge to persuade the client to pursue a course of action more in line with the lawyer's interests. Although this conflict might arise in every professional-client relationship, it was especially dangerous under an event-triggered fee arrangement, where the client had less capacity to control the lawyer.

- Proponents of event-triggered fees, on the other hand, argued that event-triggered fees in fact aligned the lawyer's interests with those of the client. It might be said that clients would prefer their lawyers to be interested in the outcome of litigation and to display greater diligence and commitment to the case. In the present system, where the lawyer was paid irrespective of

outcome, the lawyer might have less incentive to pursue the matter diligently or expeditiously.

(iv) Excessive fees

- The American contingency fee system could result in the lawyer receiving fees disproportionate to the effort expended in a case, since the lawyer's payment was calculated as a percentage of the amount awarded. However, this criticism applied only to contingency fees and not to conditional fees, which were based on the lawyer's normal fees supplemented by an uplift for taking the risk.[16]

(v) Freedom of contract

- Since event-triggered fees were suggested as an alternative to, but not as a replacement for, other conventional bases of charging, solicitors and clients were allowed greater freedom of contract. Neither party was obliged to adopt event-triggered fees against their wishes.

- It could be said, however, that parties to a contract must have equal bargaining power for there to be true freedom of contract. Given his professional training and experience, the lawyer's bargaining power might be superior to that of his client.

Conclusions of the SALC

6.6 Having set out the arguments for and against the introduction of event-triggered fees, the SALC concluded that:

> *"The contingency fee system as operative in the United States of America is generally branded as the scapegoat giving lawyers a bad reputation. … However, the contingency fee system is defended in America as the only system yet devised that permits the ordinary citizen equal access to the courts, as well as guaranteeing the availability of counsel equally skilled and knowledgeable as those available to the monied and corporate classes. In any event, it would appear that the harshest criticism against the American system is levelled at the use of percentage fees.*
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> *The disadvantages of contingency fee arrangements have not precluded them from being recently introduced in countries such as England and Wales and in different parts of Australia, notwithstanding the fact that due cognizance was taken of the dangers inherent in the system. The overriding argument which*

[16] There are views that fees charged under the conditional fee system can be regarded excessive, if a high percentage of uplift is charged for taking a low risk.

weighed heavily in favour of the adoption of contingency fees is its potential for increasing access to justice. …

… If the courts should experience difficulty in dealing with an increased load of litigation owing to the introduction of contingency fees, ways of expanding the courts should be investigated rather than depriving people of their right to pursue meritorious claims.

In the Commission's view the potential of contingency fees creating a conflict of interests between lawyers' duty towards their clients and to the courts would raise a serious concern. However, this inherent danger of contingency fees would appear to be insufficient, per se, to warrant the rejection of contingency fee arrangements. … Sufficient safeguards should essentially be built into any system of contingency fees to minimize the disadvantages of the system and to guard against its abuse."

Contingency or conditional fees

6.7 In an article entitled *The United States Percentage Contingent Fee System: Ridicule and Reform From an International Perspective*,[17] Aranson argued that the UK conditional fee system was preferable to the American contingency fee system.

6.8 In Aranson's view, the American contingency fee system was unique, and the United States of America was the only country which allowed a lawyer to receive a percentage of an award or settlement of a case as a fee.[18] Although the system opened the courthouse doors to the poor, it had attracted much criticism. Aranson did not question the validity of event-triggered fees (and, indeed, almost every commentator agreed that some form of event-triggered fees was essential to facilitate access to justice in the United States) but instead proposed that reforms should be made to maintain the advantages and mitigate the disadvantages of the contingency fee system.[19]

Criticisms of the American contingency fee

6.9 Aranson pointed out that, because of the percentage basis of the fee, lawyers might be more likely to choose to represent clients with frivolous claims, to pursue cases with their own interests in mind rather than their clients' interests, and to extract excessive fees at the conclusion of the case.

Frivolous litigation

6.10 Aranson pointed out that, if a lawyer took several cases on a

17 Allison F Aranson, Texas International Law Journal (Summer 1992), 27 Tex Int'l LJ 755.
18 Aranson, cited above, at 760.
19 Aranson, cited above, at 757.

contingency fee basis, the cost of a losing frivolous case would be offset by the rewards from frivolous cases that prevailed. Lawyers could subsidise baseless cases by using funds from contingent cases in which they had succeeded to cover the litigation costs. Hence, lawyers could gamble compensation from frivolous cases on the bet that a baseless claim would be profitable because of the pressure on the defendant to settle. The greater the extent to which compensation exceeded the normal hourly fee, the greater the chance of abuse. In Aranson's view the chance of abuse was therefore greatest with the percentage contingency fee.[20]

6.11 Aranson also commented that the contingency fee system offered lawyers the most tempting incentive to initiate cases for their settlement value, clogging the legal system with litigation and resulting in costly delays for all. When companies were "blackmailed" into paying settlements for unmeritorious claims, consumer costs increased and the poor would also suffer in the end.[21]

Conflict of interest

6.12 Although proponents of contingency fees claimed that they aligned the interests of lawyer and client because each wanted the highest recovery possible, Aranson pointed out that a conflict arose as the lawyer wanted the highest recovery in the shortest amount of time possible, while the client simply wanted the highest recovery, regardless of the amount of time the lawyer spent on the case.

6.13 The client's and the lawyer's interests were aligned only when the case promised a large award from a jury trial. Yet the vast majority of cases engaged on a contingency fee basis settled. By settling a case quickly, a lawyer could receive a large fee without expending much time on the case. Because a case which settled could be dealt with more quickly than one which went to trial, there was an additional incentive for the lawyer to take on a large number of contingency fee cases to maximise profits.

6.14 Aranson quoted Herbert M Kritzer,[22] an expert on the effect of fee arrangements on lawyers' work habits, who found that lawyers were not motivated purely by self-interest and profit maximisation. Rather, such incentives were tempered with "*competing values including professional standards and a sense of responsibility to the client.*"[23] Aranson commented that the temptation for unethical conduct should not go unwatched. Although lawyers should not be expected to behave altruistically, the fee system should at least make it less profitable for the lawyer to travel down an unethical path.[24]

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20 Aranson, cited above, at 762.

21 As above.

22 Herbert M Kritzer, *The Impact of Fee Arrangement on Lawyer Effort* (1985), 19 Law & Soc'y Rev 251, 272.

23 Kritzer, above cited, at 253.

24 Aranson, above cited, at 766.

Excessive fees

6.15 Aranson argued that contingency fees were detrimental to the client's interest, as they resulted in excessive fees being paid to the lawyer at the conclusion of the case. A lawyer's fees could be regarded as excessive if they were not justified in terms of, first, the time and effort expended by the lawyer and, second, the risk of no payment.

6.16 In terms of the time and effort expended on the case, Kritzer's study revealed that a lawyer hired on a contingent fee basis was likely to work seven hours less on a typical $6,000 claim than a lawyer hired on an hourly basis. Those seven hours represented nearly 22% of the time spent on a typical $6,000 case.

6.17 In terms of the risk of no payment, Aranson pointed out that over 90% of cases taken on a contingency fee basis settled before trial, and the defendant won in only 50% of those that went to trial. Indeed, the lawyer risked receiving no fee in only 5% of cases.

6.18 Aranson commented that, rather than reflecting the lawyer's investment of his time and effort and the risk taken, the excessive fees reflected the scarcity of information available to clients searching for adequate representation. Clients did not possess the necessary information to compare the services rendered by different lawyers. In a survey by the American Bar Association, it was found that 80% of these surveyed believed that people did not seek legal advice because of the difficulty of identifying competent lawyers.[25] The client, who knew little about the cost and nature of legal services, would usually assume that the lawyer he had chosen was competent and charged a fair fee.[26]

6.19 In mass tort cases, the fact that the lawyers could repeat the same arguments for multiple plaintiffs incurred low marginal costs and offered a chance for even further pecuniary gain.

6.20 Statistics show that in the average tort lawsuit with a contingent fee arrangement, approximately 24% of the total award goes to the plaintiff's legal fees and expenses. In contrast, the defendant's legal fees and expenses total approximately 18% of the total compensation.[27] It is small wonder that 97% of United States lawyers were found to accept personal injury cases on a contingency fee basis only, regardless of the client's ability to pay the lawyer's standard hourly rate.[28]

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25 Peter H Schuck, *Consumer Ignorance in the Area of Legal Services* (1976), 43 Ins Couns J 568, 568 Quoted by Aranson at 769.

26 Richard M Birnholz, *The Validity and Propriety of Contingent Fee Controls* (1990), 37 UCLA L Rev 949, 954. Quoted by Aranson at 770.

27 Kakalik & Pace, *Costs and Compensation Paid in Tort Litigation* (1986) at 71. Quoted by Aranson at 772.

28 Crovitz, *Contingency Fees and the Common Good*, Wall St J 21 July 1989, at A14.

Advantages of conditional fees

6.21 Having set out the disadvantages and problems of the US contingency fee system, Aranson proposed that the American contingency fee system should be reformed along the lines of the British conditional fee system. Such a change would retain the advantages of event-triggered fees, but avoid the problems of contingency fees. In other words, it would allow access to the courts, while discouraging frivolous litigation, and avoiding conflict of interest and excessive fees.

Frivolous litigation

6.22 Aranson believed that the amount of frivolous litigation would be reduced under a conditional fee system. Without the windfall gain and excessive fees of the contingency fee system, the lawyer would not have the excess funds to subsidise unmeritorious claims which nonetheless have a high nuisance value.

Conflict of interest

6.23 In a contingency fee system, the interests of the lawyer and his client can conflict on settlement issues. Aranson suggested that, under a conditional fee system, the lawyer and his client can adjust the uplift (or success fee) at each stage of the trial to reflect the actual risk the lawyer has assumed. This is in line with the UK Court of Appeal's suggestion in *Callery v Gary* of a two-stage success fee.[29]

Excessive fees

6.24 Aranson observed that, unlike the contingency fee system, the conditional fee system takes into account the number of hours worked and the lawyer's hourly fees in calculating the success fee. This constitutes a check on the amount of legal fees payable, and lawyers must record the number of hours expended on the case. These records provide a basis for the court to decide on the reasonableness of the fees.

6.25 Aranson stated that the conditional fee system could deter excessive fees only if: (1) clients have easy access to information on lawyer's fees; and (2) there is adequate judicial scrutiny of legal costs. Aranson urged professional bodies and consumer groups to disseminate that information to help the client find the best deal.

6.26 Aranson added that converting the American contingency fee system to a conditional fee system would align the American fee system with that of other countries.

[29] See discussion in Chapter4. (Nos 1 and 2) [2002] 1 WLR 2002-2032.

The English Court of Appeal in *Awwad v Geraghty & Co* – pros and cons of conditional normal fee agreements

6.27 In discussing whether or not a conditional fee agreement was against public policy, Lord Justice Schiemann in *Awwad v Geraghty & Co*[30] set out the arguments both for and against the enforceability of conditional normal fee agreements.[31]

6.28 The arguments in favour of conditional normal fee agreements were:

> *"(1) A conditional normal fee arrangement is of advantage to the client.*
>
> *(2) It does not, on its face at any rate, increase the potential liability for costs of the client's litigation opponent should he in due course be ordered to pay the costs of the litigation.*
>
> *(3) It is of potential advantage to the litigation opponent of the client in that, if such opponent is awarded costs against the client, the client's assets from which those costs must be taken will be larger because they will not have been diminished by costs owed to the client's own lawyer.*
>
> *(4) The agreement does not involve any division of the spoils in the way that a contingent fee agreement does and in the way in which, arguably, a conditional uplift fee agreement does (since the winnings produced by the litigation will produce or swell the assets from which the uplift will have to be found). There is therefore no extra incentive for the lawyer to stir up litigation.*
>
> *(5) The temptation to the lawyer to act improperly is less than it would be if the agreement was a contingent fee or conditional uplift agreement.*
>
> *(6) If the lawyer's client has no assets then a conditional normal fee agreement merely gives legal form to what is a practical reality – the lawyer only gets paid if the client wins. Yet it is accepted as laudable for lawyers to act in such circumstances.*
>
> *(7) There is nothing improper in the lawyer agreeing to act for the client for his normal fee whilst having it in his mind, for reasons of friendship or wishing to foster future work from*

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30 [2000] 3 WLR 1041, at 1056-1057.

31 This is also referred to as a "speculative fee". It means that no uplift is involved, and the lawyer is paid only his normal fee on success.

that client, not to exact his fee if the client should lose. It seems odd that an open contractual statement of what is unobjectionably in a solicitors' mind should render unenforceable an agreement which would have been enforceable had the solicitor not shared his thoughts with his client and promised not to change his mind.

(8) Situations can arise where initially a normal fee agreement is entered into between lawyer and client. Thereafter the client, before the conclusion of the litigation, becomes financially unable to promise to continue to pay his lawyer even if he loses. It is manifestly undesirable for the lawyer to leave the client in the lurch. A conditional normal fee agreement covering the remainder of the litigation, perhaps the last day of a trial which has run for longer than expected, has much to be said for it. The distinction between waiver at that point and waiver after the conclusion of the case is a nice one.

(9) A conditional fee agreement facilitates access to the courts by members of the public.

(10) Leave to appeal against the Thai Trading case was refused by the House of Lords. Although in general the mere refusal of leave by the House lends no added authority to a decision of this court, had the Thai Trading case been perceived by their Lordships as permitting something which was illegal and against public policy then it is probably reasonable to suppose that leave would have been given."

6.29 The arguments against conditional normal fee agreements were:

"(1) The public interest in the highest quality of justice outranks the private interests of the two litigants. This renders it particularly important that lawyers should not be exposed to avoidable temptations not to behave in accordance with their best traditions.

(2) The concept of a 'normal' fee is singularly elusive – some solicitors' normal fees are a multiple of those charged by others for what on the face of it is the same work.

(3) It would be very difficult and undesirable for the answer to the question whether or not an agreement is illegal to depend on a detailed examination in each case of solicitors' costs structures.

(4) If solicitors' practices are set up, the bulk of whose business is conducted on the basis of conditional normal

fees arrangements, then their normal fees would presumably have to be higher than they would have been had such arrangements not been normal in the firm."

Other criticisms of conditional fee agreements

6.30 Zander has put forward further criticisms of the conditional fee system:[32]

> *"• There is an intrinsic conflict of interest in the method of calculating the success fee. It is in the solicitor's interest to over-estimate the risk of the case to justify a higher success fee. The study of clients in conditional fee agreement cases showed that they did not understand conditional fee agreements sufficiently to identify this conflict.*
>
> *The regulation of the scheme did not adequately ensure that solicitors related the success fee to the risk in the case. Regulation hinged on the right of clients to request taxation (now called 'assessment') of the success fee by the courts but in practice this did not happen.*
>
> *Competition was insufficiently strong to influence success fees."*

6.31 Zander pointed out that research by Yarrow[33] showed that:

- The vast majority of completed conditional fee agreement cases (93%) were successful in the sense of achieving a settlement or a judgment wholly or partly in favour of the client. This was in contrast to solicitors' pessimism in an earlier study as to the likely success rate. A 41% average success fee would be appropriate to a case with a 70% chance of success, but in fact 93% of cases succeeded. The success fee appropriate to a case with a 93% chance of success would be only 8%.[34]

- The success fees written into the conditional fee agreement were higher than would have reflected the actual, very low, risk of losing.

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32 Michael Zander, "Will the Revolution in the Funding of Civil Litigation in England eventually lead to Contingency Fees?" (Spring 2003) De Paul Law Review <www.lse.ac.uk/Depts/Law>.

33 S Yarrow, *Just Rewards (2000)*. The study was based on a sample of 197 cases supplied by a representative sample of 58 solicitors' firms specialising in personal injury work. The research consisted of interviews with lawyers in 16 of the 58 firms and details of just over half of the 197 cases (56%) that were completed. Fieldwork ended in March 2000.

34 Note also that COOK ON COSTS 2000 states (at 468) that over 95% of personal injury, other than clinical negligence, claims succeed. It would be difficult to justify a success fee of more than 5-10% in a normal personal injury claim.

- The mean success fee actually taken by solicitors (29% of costs) was lower than the mean success fee agreed in the conditional fee agreement (43% of costs). In some cases, this may have reflected the voluntary 25% cap which applied at that time to the proportion of damages which should be taken. In a few cases, the solicitor may have shared the success fee with the barrister, while in others the solicitors may not have taken the full success fee to which they were entitled.

- Nevertheless, despite this reduction, the mean success fee taken was still higher than the actual success rates would suggest was appropriate.

Other issues to be considered

Counsel

6.32 In England, like solicitors, barristers working under conditional fee agreements will be entitled only to an uplift of their profit costs and fees as agreed or allowed on taxation. The uplift will be restricted to a maximum of 100%. Like solicitors, barristers will not be able to claim a percentage of the damages awarded. Solicitors will be expected to fund all necessary disbursements, which include the payment of counsel's fees unless counsel is also willing to act under a CFA.

6.33 In a publication entitled *The Law Society Conditions,* the English Law Society clarifies as follows the implications of the involvement of counsel in contingency fee arrangements:

> *"Payment for advocacy*
>
> *The cost of advocacy and any other work by us [ie the client's firm of solicitors], or by any solicitor agent on our behalf, forms part of our basic costs.*
>
> *Barristers who have a conditional fee agreement with us*
>
> *If you win, their fee is our disbursement which can be recovered from your opponent. You must pay the barrister's uplift fee shown in the separate conditional fee agreement we make with the barrister. We will discuss the barrister's uplift fee with you before we instruct him or her. If you lose, you pay nothing.*
>
> *Barristers who do not have a conditional fee agreement with us*
>
> *If you lose and you have not been paying the barrister's fees on account, we are liable to pay them. Because of this, we add an extra success fee if you win. This extra success fee is not added*

if you have been paying the barrister's fees on account. If you win, you are liable to pay the barrister's fees."

6.34 Hence, in England and Wales (unlike the position in Scotland), it is possible to have a time-cost barrister working with a conditional fee solicitor in the same case.

6.35 A recent publication[35] written by a practitioner highlights some of the changes to the work of barristers brought about by the introduction of conditional fee agreements and the reforms of legal aid in England. The main points are as follows:

(i) *"There is no doubt that the combined effect of the advent of CFAs, the loss of legal aid funding and the success of the pre-action protocol have placed a considerable cash flow strain on even the most successful chambers. A few years ago, personal injury counsel would have had a constant diet of legal aid advices because of the legal aid certificate requirements in many cases to obtain counsel's advice both on the merits of the case and the level of quantum, and in most cases to obtain further advice on evidence. The entitlement to claim payments on account of those fees provided counsel with a regular income."*[36]

(ii) *"The success of the pre-action protocol has seen a considerable reduction in the number of cases going all the way to trial, and thereby requiring counsel's advice, drafting and advocacy. In addition to the loss of payments on account from legal aid, counsel, unlike solicitors, are not receiving the throughput of cases to build up the war chest of fees."*[37]

(iii) *"Many counsel are becoming involved in cases of the riskier categories, such as work-related upper-limb disorders and stress at work. Understandably, they are reluctant to undertake these on CFA basis. Unfortunately this conflicts with the needs of their instructing solicitors, who require advice and representation in cases of just this type."*[38]

(iv) *"One of the reasons that solicitors have become increasingly reluctant to instruct counsel is the frequent difficulty of persuading counsel to work on a CFA. They do not wish to instruct them privately because they will have to pay that fee if their client loses. Many of the ATE*

35 M Harvey, *"Guide to Conditional Fee Agreement"*, Jordans 2002.
36 At 151.
37 As above.
38 At 152.

insurers will not treat counsel as a disbursement. However, this may be the key."[39]

(v) *"The judgments in Callery v Gray and Halloran v Delaney have offered no real guidance as to the level of counsel's fees, although the principles of risk which the Court of Appeal enunciated will apply equally to counsel. … [C]ounsel's experience of risk differs substantially from that of solicitors. To begin with, they are not building up the fees on successful claims in the same way as solicitors and when they are instructed, more often than, not, it is later in the case and with considerably greater risk. … Indeed, if counsel is being instructed in a case where the pre-action protocol procedure has not produced a settlement, then there is clearly a serious defence. If, as is most common, counsel is not instructed until the drafting of proceedings, or even after exchange of witness evidence, the risk is very considerable. If the matter is going to trial, clearly the defendants believe they can win the claim. This puts the prospects of success at 50/50. There is therefore a substantial ground for setting counsel's success fees at 100%"*[40]

(vi) *"Counsel should therefore consider setting two success fees … One at 100% for the matter going to trial and one lower one to reflect the cost to counsel of losing cases …".*[41]

6.36 Mark Harvey has also suggested various methods[42] of financing counsel's fees:

(i) *Deferred fees* – This involves counsel agreeing to defer his fees until the conclusion of the case. In such a situation, the solicitor is bearing a greater risk should the claim turn out to be unsuccessful and, unless the client has agreed to bear counsel's fees as disbursements, the solicitor should increase the success fee to reflect the higher risk.

(ii) *Discounted conditional fees* – If the straightforward "no win, no fee" arrangement is not attractive to counsel, the solicitor may try to negotiate a "no win, reduced fee – win, full fee" arrangement.

(iii) *Varying the terms of the conditional fee agreement* – There is usually a term in the agreement that requires counsel to find an alternative counsel for trial if he himself is not available. This term may be too onerous to counsel if the case is risky. The

39 At 152.
40 At 154.
41 At 155.
42 At 140-141.

deletion of the requirement may convince counsel to take on the case.

(iv) *Counsel's fees as disbursements* – A small number of ATE insurance providers are able to treat counsel's fees as disbursements and so counsel will be paid, win or lose.

6.37 These points should be borne in mind in devising any scheme of event-triggered fees in Hong Kong. It falls to be considered whether barristers should be subject to a higher maximum uplift than solicitors, to mitigate the difficulty of finding a competent barrister to represent clients who have a worthy cause but require conditional fee financing. An alternative would be to explore the possibility of ATE insurers including counsel's fees as disbursements as a normal practice.

Insurance

6.38 It is apparent that the availability of insurance is a key factor in making the conditional fee system work. Whether the market in Hong Kong is large enough to allow a number of insurance companies to compete and survive should be investigated and considered.

6.39 It may be useful to note that in England, when conditional fee agreements first became lawful in 1995, only the Law Society–approved "Accident Line Protect" was available, offering a low fixed premium of £85 per case regardless of the type or value to members of the Personal Injury Panel.[43] Within three years, the scheme was in difficulties, primarily through adverse selection of cases by solicitors.

6.40 Since 1995, providers of ATE insurance have grown to around a dozen. In reality, the majority are brokers and the number of underwriters operating in the market is around five.[44] However, underwriters have suffered greater losses than they had anticipated, and there is a danger that in the near future the demand for ATE insurance may not be fully met.[45]

6.41 An issue which needs to be considered is whether the recoverability of ATE premiums and success fees has any impact on the level of insurance premiums and the availability of ATE insurance.

Intermediaries

6.42 Since the abolition of criminal and civil liability for champerty and maintenance, claims intermediaries sometimes referred to as compensation claims agents, claims management companies or claim farmers, have proliferated in England, typically by maintaining a high profile through

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[43] Contrast the premium of £367.50 (tax inclusive) in *Callery v Gray* in 2000.

[44] M Harvey "*Guide to Conditional Fee Agreements*" Jordans 2002 at 115.

[45] As above.

aggressive TV marketing campaigns. Concern over the activities of claims intermediaries has been a constant theme over the last few years. The collapse of Claims Direct, the Accident Group and others has focused attention on the business models of claims intermediaries. Allegations of high-pressure sales, exaggerated or low-quality claims, expensive and opaque insurance products covering items that are irrecoverable between the parties, and high-interest loans to clients with no credit checks have served to paint a poor picture of this sector. Clients often have not fully understood the liabilities they were undertaking when signing up for insurance and loans offered to them by the sales agents to facilitate the claim. Many respondents to the consultation expressed concern at the way in which some intermediaries obtained their business, and the suitability of ATE insurance and loan products sold to claimants. In some instances, it is questionable whether claims intermediaries add value or simply an extra costly tier to the claims process.

6.43 According to the views collected by the UK Department for Constitutional Affairs from its consultation exercise in 2003,[46] a number of problems have emerged in the claims intermediaries sector, which are summarised as follows:

> *"Many respondents expressed grave concerns over the behaviour and conduct of claims intermediaries in marketing and selling their products. Unlike solicitors, who are bound by a professional code of conduct, claims intermediaries are unregulated. However, the respondents also recognised the important role that intermediaries have in informing consumers of their legal rights. The respondents suggested that regulations should be considered to control the activities of these intermediaries.*
>
> *The Law Society believed that it was crucial that the claims management industry be subject to regulation if they were to be involved in the provision of advice under CFAs. Citizens Advice suggested that primary legislation be introduced to bring claims intermediaries within the scope of legal services regulation. The Federation of Small Business (FSB) stated that CFAs had encouraged the emergence of claims farmers who derive their income from persuading clients to make a claim without any real investment in the merits of the action. The FSB also felt that claims were now more complex, with each claim being broken down so that every small detail is priced. This has increased the costs of claims. The FSB would like to see a simpler system for making claims, and proposed that some restrictions should be placed on the various types of claim made under CFAs."*

[46] DCA, *Consultation Paper on Simplifying CFAs*, June 2003.

Regulation of claims intermediaries in England

6.44 There is some existing regulation of aspects of the legal and financial package services that claims intermediaries offer to the public. For example, the Law Society and the Bar Council regulate the conduct of solicitors and barristers respectively who work with, or take work from, these companies. Their activities may be covered by trading standards legislation, including the supply of goods and services, unfair contract terms and trade descriptions. Their advertisements are under the purview of the Advertising Standards Authority and the Office for Communications. There is, however, no sector-specific regulation.

6.45 In 2003 and 2004, the sudden collapse of several claims intermediaries gave rise to concerns from consumers and solicitors. At present, claims intermediaries in England may join the Claims Standards Council on a voluntary basis. Only a small proportion of claims intermediaries have opted to join the Claims Standards Council. In November 2004, the UK Government proposed that the Claims Standards Council should work vigorously towards approval of its code of practice by the Office of Fair Trading, with the hope that the code of practice would raise the standards of claims intermediaries.

6.46 In December 2004, the Final Report by Sir David Clementi on the Review of the Regulatory Framework for Legal Services in England and Wales was published and claims intermediaries were identified as one of the regulatory gaps.[47] The UK Secretary of State for Constitutional Affairs and Lord Chancellor, Lord Falconer announced on 21 March 2005 that a White Paper would be released later in 2005 followed by legislation to reform the market for legal services. That legislation will include new provisions specifically to bring the claims intermediaries within the regulatory net.

Mode of operation of claims intermediaries in Hong Kong

6.47 There is anecdotal evidence that compensation claims agents are becoming more active in Hong Kong. While the fact that unregulated and unqualified persons are providing legal services to the public may be a cause for concern, there have been no serious complaints about the operation of Hong Kong compensation claims agents. The Consumer Council, for example, has no record over the past two years of any complaint against such organisations, although the Consumer Council has acknowledged that this does not necessarily indicate that there have been no unfair practices.

6.48 According to an article in the Consumer Council's "Choice" magazine, claims intermediaries operate under the pledge of "no win, no fees". They employ lawyers on behalf of the client and will pay the necessary disbursements up front. If no recovery is made, the claimant need not pay anything. If the claim results in recovery, the intermediary will usually take

[47] For an earlier review, see The Blackwell Report published in April 2000.

20% - 30% of the compensation received as a service charge. Claims intermediaries therefore select their clients and accept those cases which are more likely to win.[48]

6.49 There are unsubstantiated reports that some claims intermediaries are run by solicitors using a limited company as the business vehicle. Salesmen are employed to solicit business, sometimes by approaching accident victims in hospitals. There is also anecdotal evidence that some claims intermediaries have approached legally-aided clients and attempted to persuade them to abandon legal aid.

6.50 Preliminary research by the Consumer Council indicates that advertisements for these services do not appear to be widespread in the mainstream media, though some claims intermediaries advertise on websites, through telephone listings, or in publications that are distributed free of charge. However, in August 2002, a claims intermediary advertised its services on a local Chinese TV channel. This may be a sign that claims intermediaries have become more widespread and are employing more aggressive marketing tactics.

6.51 Given that legal practitioners are not allowed to charge any form of event-triggered fees, the services offered by claims intermediaries are unique, as they operate on a contingency fee basis similar to that adopted in the United States.

Relevant regulations and rules

6.52 We noted earlier in this paper[49] that a solicitor may not enter into a conditional or contingency fee arrangement to act in contentious business. That restriction stems from legislation, conduct rules and the common law offences of champerty and maintenance. Therefore, if a legal practitioner uses a claims intermediaries company as a facade to charge contingency fees, he may be guilty of the common law offence and may have contravened relevant legislation and professional conduct rules.

6.53 If a solicitor or barrister accepts referrals from claims intermediaries, and in return offers kickbacks or shares profits with the intermediary, that may amount to a breach of rule 4 of the Solicitors' Practice Rules (which prohibits the sharing of fees with non-qualified persons) or paragraph 92 of the Bar Code (which prohibits a barrister from giving a commission or present to any person who introduces work to him).

6.54 Persons other than solicitors and barristers, depending on the facts of the case, may be caught under the Legal Practitioners Ordinance (Cap 159), which makes it an offence for a person to practise as a barrister or

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[48] November 2002. There are, however, anecdotal evidence showing that sometimes compensation claims agents will take on even weak or wholly unmeritorious cases for their nuisance value, if they believe that the defendant can be forced into settlement.

[49] Chapter 1.

notary public, or to act as a solicitor, if he is not qualified to do so. There are also offences in respect of unqualified persons who prepare certain documents relating to the commencement and conduct of proceedings.[50]

6.55 Unqualified persons may, depending on the facts of the case, be guilty of the common law offence of maintenance and champerty. Maintenance may be defined as the giving of assistance or encouragement to one of the parties to litigation by a person who has neither an interest in the litigation nor any other motive recognised by the law as justifying his interference. Champerty is a particular kind of maintenance, namely maintenance of an action in consideration of a promise to give the maintainer a share in the proceeds or subject matter of the action.

6.56 There have been cases where organisations have been prosecuted for, and convicted of, being unqualified persons who act as solicitors. However, these cases were not specifically related to accident compensation assistance. The Bar Association recently issued a report on recovery agents. The Law Society issued a circular on 17 May 2005 to its members, advising them that the practice of recovery agents is a criminal offence in Hong Kong, and lawyers risked committing professional misconduct if they worked on cases financed by recovery agents.

Pros and cons

6.57 The Consumer Council is of the view that if services offered by claims intermediaries are widely accepted by the public, this may reflect the fact that the existing legal sector has not fully met the needs of the general public. The Consumer Council also noted that the major clientele of claims intermediaries are those who are not eligible for legal aid but do not have the means to afford the normal litigation costs. It could be argued that these intermediaries provide a service to those whose needs would otherwise remain unmet by conventionally funded legal services.

6.58 The “no win, no fee” arrangements provided by claims intermediaries could be said to provide the client with a clear delineation of the extent of his costs liability, in contrast to the conventional time-cost basis on which lawyers charge. It could be argued that the time-cost approach to charging presents the lawyer with an interest in procrastination and delay, in marked contrast to the claims intermediary’s interest in speedy settlement and maximising the amount of compensation.

6.59 On the other hand, some are sceptical of the operation of claims intermediaries for reasons which include:

(i) The background, training or knowledge of claims intermediaries is unknown.

[50] Also in respect of some documents on conveyancing and the administration of a deceased person’s property.

(ii) The level of supervision is unknown.

(iii) There is a serious risk of conflict of interest in that disbursements such as medical fees or other experts' fees are kept to a minimum (because the claims intermediary pays for these fees himself) in the hope of a settlement, with the result that cases are not properly advised, assessed or prepared for trial.

(iv) There is a risk that settlements are reached on commercial considerations, and not according to the best interests of the claimants. For example, substantial claims may be settled for relatively modest sums to the detriment of the claimant.

(v) For clients who have a strong claim which is likely to result in a substantial award, the client may end up paying more than he would under a conventional time-cost arrangement.

(vi) If the case is lost and the compensation claims agent is unable or unwilling to pay the opponents' legal costs, the client has virtually no protection, given that it is likely that the claims intermediary is uninsured and has limited liability.

The impact of allowing legal practitioners to charge event-triggered fees on claims intermediaries

6.60 If legal practitioners in Hong Kong are allowed to charge event-triggered fees, and if the common law offences of maintenance and champerty are abolished, those changes are likely to impact on claims intermediaries. On the one hand, legal practitioners will become more price-competitive, which may take away business from the claims intermediaries. On the other hand, claims intermediaries may employ aggressive marketing techniques to enhance their share of the litigation market, as in the case of England.

6.61 There is no evidence to suggest that if claims intermediaries were not available their clients would avail themselves of conventional legal services provided by the legal profession. Indeed, as we pointed out above, the Consumer Council believed that the majority of claims intermediaries' clients were persons who fell outside the legal aid net, and who could not afford to engage a lawyer on their own account.

The Hong Kong situation

Access to the courts

6.62 Access to the courts is one of the fundamental rights

constitutionally protected by the Basic Law.[51] If some segments of society cannot afford to pay legal costs, they are effectively deprived of access to justice. The growing number of unrepresented litigants would suggest that there is a significant proportion of the community who are not eligible for legal aid, but cannot afford the high costs of litigation.

6.63 This increase in unrepresented litigants is one of the major problems confronting the civil justice system in Hong Kong, and there is no doubt that unrepresented litigants have become a major feature of the litigation landscape in Hong Kong. For interlocutory hearings in the High Court before Masters,[52] the percentages of hearings involving unrepresented litigant(s) for the years 2001 – 2004 remain at about 34%.[53] As for civil trials and civil appeals in the High Court, the percentage rose from about 37% in 2001 to 42% in 2004.[54] As for civil trials in the District Court, the percentage during the years 2001 – 2004 remain at about 49%.[55]

Why people are unrepresented

6.64 The Australian Law Reform Commission ("the ALRC") has researched the issue of unrepresented litigants, and published a Background Paper in 1996. The ALRC found that:

> *"While some people may choose to represent themselves in court, it is likely that many litigants in person are without legal representation because they cannot afford it and do not qualify for legal aid. A close relationship can be expected between the number of litigants in person and the extent to which people are able to obtain civil legal aid or other legal assistance through pro bono schemes, access to speculative and contingency fee arrangements and other forms of legal and litigation assistance."*[56]

Impact of unrepresented litigants

6.65 When assessing the impact of unrepresented parties on proceedings, a distinction must be drawn between complex and routine matters. For routine matters, such as those usually dealt with by tribunals, it is generally agreed that substantial savings in legal costs can be achieved by limiting or forbidding legal representation. For complex matters, however, the

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51 Article 35: "Hong Kong residents shall have the right to confidential legal advice, access to the courts, choice of lawyers for timely protection of their lawful rights and interests or for representation in the courts, and to judicial remedies. Hong Kong residents shall have the right to institute legal proceedings in the courts against the acts of the executive authorities and their personnel."

52 It covers all Chambers and Court hearings before Masters where the estimated length is one hour or above.

53 2001 : 34%, 2002 : 33%, 2003 : 34%, 2004 : 36%.

54 2001 : 37%, 2002 : 43%, 2003 : 45%, 2004 : 42%.

55 2001 : 48%, 2002 : 49%, 2003 : 47%, 2004 : 49%.

56 Australian Law Reform Commission, *Background Paper on the Unrepresented Party*, December 1996, Chapter 3.

lack of professional representation constitutes a serious burden for all concerned.

6.66 Litigants in person may impact adversely on the costs of other parties and on the time taken to complete proceedings. The cost to represented litigants when they are faced with an unrepresented litigant may be increased by:

- more time being spent in directions hearings, motions and hearings;
- more costs being incurred in responding to the broad-brush evidence that may be relied on by unrepresented litigants;
- a reduction in trial certainty and an inability to advise properly as to probable costs; and
- increased costs incurred as a result of poor issue definition and clarification.[57]

6.67 Litigants in person are a problem for the adversarial system of litigation, premised as it is on two equally matched sides able to present their respective cases with skill and in full.[58] Lord Woolf has commented that the judge should ensure that the unrepresented party gets a fair hearing and understands the outcome of the case. He has recommended that judges should be prepared to adopt an interventionist approach and the handling of such cases should be incorporated in judicial training.[59]

6.68 However, there are limits on how far a judge can depart from the traditional detached role in the adversarial system to render assistance to the unrepresented litigant. In fact, Lord Devlin has commented that where there is no legal representation, and save in the exceptional case of the skilled litigant, the adversarial system, whether or not it remains in theory, in practice breaks down.[60] Professor Cranston has commented that, if only in the interests of efficiency, some assistance must be given to the litigant in person, given the burdens such litigants impose and the more extended hearings which can result.[61]

6.69 The problem of unrepresented litigants is putting pressure on the civil justice system in Hong Kong, especially on the court's bilingual facilities, since the vast majority of unrepresented litigants would wish the proceedings to be conducted in Chinese.[62] Although various measures can be developed to meet the needs of unrepresented litigants, the most direct response is to secure legal representation for litigants in person.[63]

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57 ALRC, cited above.

58 Professor R Cranstone, *Access to Justice Background Report for Lord Woolf's Inquiry*, Lord Chancellor's Department London 1995, 151. Cited in ALRC, cited above.

59 Lord Woolf, *Access to Justice; Interim Report to the Lord Chancellor on the Civil Justice System in England and Wales*, 1995, 135. Cited in ALRC, cited above.

60 Lord Devlin, *The Judge*, 1979, 67 as cited in *Dietrich v R* (1992) 109 ALR 385, 389 Mason C J, McHugh J, as cited by ALRC, cited above.

61 Professor R Cranston, cited above, at 151, 157.

62 Chief Justice's Working Party on Civil Justice Reform, (Interim Report 2001) para 152.

63 As above, at para 154.

6.70 Although the issue of conditional fees falls beyond the scope of the *Interim Report and Consultative Paper on Civil Justice Reform*, some observations are made:

> *"In the United States, it has long been an accepted practice that representation may be privately funded by means of contingency fees whereby lawyers accept the cost risk against the incentive of a share in the damages if the case is won. In the United Kingdom, the civil justice system has not gone so far, but it has embraced 'conditional fee agreements'. These are agreements aimed at enabling unfunded litigants to bring claims with private lawyers bearing the cost risk, the incentive being a success fee involving an uplift by a stated percentage of the fee otherwise chargeable.*
>
> *While these are controversial developments, the argument in their favour is that they extend legal access to persons who may otherwise have no means of enforcing their legal rights. From the civil justice system's point of view, to the extent that potentially unrepresented litigants secure legal representation, such arrangements alleviate the difficulties posed by litigants in person. …"*[64]

Additional arguments for and against event-triggered fees in Hong Kong

6.71 The arguments against introducing event-triggered fees in Hong Kong include the following:

(a) There may be conflicts of interest between the lawyer and his client and the financial interests of the two may not coincide.

(b) There may be an increase in frivolous litigation, with lawyers more willing to take such cases on in the hope that the defendant may be persuaded to settle to avoid the costs of litigation.

(c) Experience in England suggests that there may be increasing complexity and uncertainty in litigation. There has been considerable judicial discussion in England of the costs indemnity rule, the recoverability and reasonableness of success fees and insurance premiums, and the public policy considerations.

(d) An important element of a successful conditional fee regime is the availability of ATE and BTE insurance to cover legal costs. There is no certainty that insurers in Hong Kong would be willing or able to provide such cover.

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64 As above, at paras 157 – 158.

6.72 The arguments in favour of some form of event-triggered fees include the following:

(a) Access to justice and the means to seek a legal remedy would be provided to the significant proportion of the community who are currently neither eligible for legal aid nor able to fund litigation themselves.

(b) The suggestion that conditional fees introduce an inherent conflict of interest not present with conventional fee arrangements is fallacious. Under conventional fee arrangements, the unscrupulous lawyer's interests lie in maximising his fees by delay and obfuscation, in conflict with the interests of his client. Equally, where the client's interests are significant and the lawyer is anxious to retain his business in the future, there are pressures on the conventional fee lawyer to win at all costs, just as there are on a lawyer acting on a conditional fee arrangement.

(c) There is no reason to suppose that frivolous claims are any more likely to be initiated where conditional fees apply than they are where conventional time-costs are charged. Indeed, the reverse could be argued. An unscrupulous lawyer could mount a frivolous claim on a conventional fee basis, safe in the knowledge that he could recover his fees regardless of the outcome of the case. There would seem less likelihood that a lawyer working on a conditional fee basis would choose to take a frivolous claim since he would receive nothing for his efforts if the claim failed.

(d) There is no doubt that there has been considerable uncertainty in the courts in England as to aspects of the conditional fee arrangements. That does not mean, however, that those difficulties could not be avoided from the outset by a clear and comprehensive legislative framework.

(e) The financial burden of allowing wide access to the courts would be shared by legal practitioners, insurance companies, litigants and the Government.

(f) The fee structure in Hong Kong would be harmonised with other jurisdictions which allow some form of event-triggered fees. These include the United States, England, Scotland, Ireland, the Australian jurisdictions, the Canadian jurisdictions, and the Mainland.

(g) The consumer would have a genuine choice between engaging a lawyer and opting for a compensation claims agent. The legal profession would be able to offer a price competitive alternative to compensation claims agents, and the consumer would be able

to choose between the regulated and policed services provided by the legal profession and those offered by the unregulated compensation claims agents.

(h) The consumer would be provided with greater choice as regards fees. In addition to conventional fees, litigants would have the alternative option of choosing to fund proceedings by way of event-triggered fees. Experience in other jurisdictions shows that event-triggered fees are popular with litigants once restrictions are removed.

Issues for consideration

6.73 It is clear that there is an unmet legal need in Hong Kong, with the courts no longer accessible to a significant proportion of the community who are ineligible for legal aid, yet cannot afford to pay the costs of litigation themselves. In such circumstances, it is timely to consider the feasibility of event-triggered fees as a supplementary institution to legal aid. The difficulties encountered by the House of Lords and Court of Appeal in England in determining whether or not conditional fees in general[65] are contrary to public policy suggest that this is not an issue appropriate for incremental judicial development over time, but rather for legislative intervention if change is thought desirable. The Sub-committee has therefore set out in the next chapter tentative proposals for legislative changes.

[65] That is, otherwise as expressly allowed by legislation.

Chapter 7

Proposals for reform

Should we allow conditional fees?

7.1 The Sub-committee has considered the arguments for and against the introduction of conditional fees set out in the previous chapter, and believes that conditional fee agreements have an important role to play in ensuring access to justice for all. It is important to ensure that making a civil claim should not be the preserve of the wealthy (who can afford to fund legal proceedings by their own resources) or the poor (who are eligible for legal aid), but open to all with good cause. If conditional fees are allowed to be used in appropriate types of civil litigation, the middle-income group in Hong Kong – people whose means are outside the limits of legal aid and the Supplementary Legal Aid Scheme – can bring a claim without worrying too much about legal costs, provided they have a strong case. The fact that the claimant can litigate with less concern for costs is balanced by the fact that only cases with good and reasonable prospects of success will be taken on by lawyers on a conditional fee basis. The Sub-committee believes that problems relating to unethical conduct, satellite litigation, increases in frivolous litigation, and excessive fees can be avoided if the conditional fee regime is properly structured.

7.2 Conditional fees would help to satisfy the unmet need for legal services which is reflected in the number of unrepresented litigants in our court system. The public should be aware that unrepresented litigants pose serious challenges, not only for themselves, but also for their opponents, the trial judge and the appellate bench. Conditional fees may appeal to litigants who would have otherwise patronised claims intermediaries, which may or may not be qualified or suitably supervised. Even to litigants who are eligible for legal aid or have other means to finance litigation, conditional fees represent an additional choice for financing litigation. We also believe that the introduction of conditional fees would enhance the competitiveness of lawyers, and would give lawyers, including less experienced lawyers, more work opportunities.

7.3 Although conditional fees were introduced in England to replace legal aid for certain types of cases, the Sub-committee, as directed by its terms of reference, has not considered the issue whether conditional fees should or could replace legal aid. Therefore, our proposals are intended to operate in parallel with, and to supplement legal aid, rather than to replace it or justify any reduction in funding.

Recommendation 1

Prohibitions against the use of conditional fees in certain types of civil litigation by legal practitioners should be lifted, so that legal practitioners may choose to charge conditional fees in appropriate cases.

Types of cases for conditional fee agreements

7.4 In England, conditional fees were initially permitted only in personal injury, insolvency, and European Court of Human Rights actions. They were extended in 2000, by virtue of the Access to Justice Act 1999, to cover all civil proceedings except criminal cases and family work involving issues concerning the welfare of children. The last two categories of cases were excluded because they were likely to be highly contentious, and there was a risk that lawyers acting on a conditional fee basis might be subject to greater improper pressure, and hence a greater risk of improper conduct.

7.5 As for Hong Kong, the Sub-committee believes that there is still a sizeable percentage of personal injury claimants falling outside the legal aid net who are deterred from making a claim because of the legal costs involved. Access to justice will be enhanced if conditional fees are made available to claimants in personal injury cases. To claimants already covered by legal aid or the Supplementary Legal Aid Scheme, the availability of conditional fee agreements offers an alternative choice to finance their litigation.

7.6 The Sub-committee believes that conditional fees can also be permitted for commercial cases in which the primary remedy sought is for damages. The term 'commercial cases' should not be narrowly construed, but should include cases involving product liability, such as liability for damages suffered as a result of defects in goods or services. Likewise, employment cases (outside of the Labour Tribunal), employees' compensation cases, probate cases involving an estate and professional negligence cases are suitable for conditional fee agreements. Family work not involving the welfare of children has been included in England's conditional fee regime since 2000 without controversy, and the Sub-committee believes a similar approach should be adopted in relation to Hong Kong's conditional fee regime.

7.7 There are indications that conditional fee agreements are useful in the insolvency sector because of the difficulties which liquidators face in funding litigation. Conditional fees can enable liquidators to recover assets and bring claims on behalf of the insolvent estate for the benefit of creditors.

7.8 As for defamation cases, it should be noted that after *Musa King v Telegraph Ltd*,[1] the use of conditional fees in defamation litigation has

[1] See discussion in paras 4.108 – 4.111 above.

become a controversial issue. The media claimed that conditional fee agreements encourage unmeritorious libel claims and inhibit the right to freedom of expression. On the other hand, defamation practitioners claim that the use of conditional fee agreements in defamation cases has greatly widened access to justice, and placed claimants on an equal footing with their generally more wealthy opponents.

7.9 Some litigation is brought where costs and damages are not the primary concern. Conditional fee agreements might not be the appropriate option for financing such litigation. Libel and defamation cases belong to this category and the damages awarded are usually low. Given the controversy surrounding the use of conditional fee agreements in defamation cases, we believe conditional fee agreements should not be extended to libel and defamation cases, at least initially.

Recommendation 2

The proposed conditional fee regime should apply to the following types of cases:

- **personal injury cases;**
- **family cases, except where the welfare of children is involved;**
- **commercial cases in which an award of damages is the primary remedy sought;**
- **product liability cases;**
- **probate cases involving an estate;**
- **insolvency cases;**
- **employees' compensation cases; and**
- **professional negligence cases.**

We believe the conditional fee regime should not apply to criminal cases, family cases involving the welfare of children, defamation cases and cases in which an award of damages is not the primary remedy sought.

Recoverability of insurance premium and success fee from the unsuccessful party

7.10 While the unsuccessful defendant should continue to bear the normal taxed legal costs of the plaintiff in accordance with the costs indemnity rule, we do not believe he should be liable for the plaintiff's ATE insurance premium and the success fee. The amounts of the insurance premium and the success fee were agreed by the plaintiff with the insurance company and the plaintiff's lawyers respectively. The defendant was not privy to these contracts, and if these bills are to be paid by the defendant, there is no financial incentive

(apart from the ability of the court to assess the "reasonableness" of the success fee charged, which is not a satisfactory means of control at all) on the part of the plaintiff, his lawyer and the insurance company to keep the pricing low. This could lead to spiraling costs and needs to be avoided.

7.11 The change in the law[2] in England in 1999 which enabled a successful plaintiff to recover his insurance premium and the success fee from the defendant has led to an explosion of litigation and this feature has become one of the major criticisms of the conditional fee regime in England. England's Senior Costs Judge, Judge Hurst, voiced the view that serious consideration should be given to ending the recoverability of success fee and insurance premiums in conditional fee cases.[3] The Sub-committee believes it is inequitable, irrational and unfair to make insurance premiums and success fee recoverable from the losing party.

7.12 In relation to the success fee, it is inequitable to recover this from the losing party because there is no good reason why the losing party should have to pay more than the value of the claimant's legal fees as objectively ascertained in the taxing of costs process on a party and party basis. There seems to be a clear inequity where the quantum of costs depends on the claimant's choice of fee arrangement with his lawyers, and not on the objectively ascertained value of the work done.

7.13 It also appears to be irrational to make a defendant pay the claimant's success fee when the stronger the defendant's case appeared at first, the higher the success fee which would be warranted. Why should a losing defendant with a weak case only have to pay a 10% success fee when a losing defendant with a 50/50 case (who therefore had more justification for defending the case) has to pay a 100% success fee?

7.14 Further, if the defendant has to pay the success fee, he should be entitled to scrutinize the conditional fee agreement critically and to examine the reasons given for setting the success fee at the stated level. The court would be unable to avoid adjudicating on these areas of disagreement. It is questionable, however, whether the courts have the know-how to adjudicate the reasonableness of a success fee, as that requires a knowledge of market conditions and commercial considerations which are usually regarded to be outside the court's purview and expertise. The fee scrutiny would be an added burden on judicial resources,[4] and the benefits, if any, of making success fees recoverable from the defendant should be balanced against the additional resources and time required of the judicial system.

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2 Access to Justice Act 1999, sections 27, 29.

3 Neil Rose, Top Judge Pushes for Recoverability Review, Law Society Gazette, 31 January 2002 at 1.

4 If fee scrutiny takes place after a trial, the parties would want to argue with hindsight what should or should not have been agreed in the conditional fee agreement. If fee scrutiny takes place before a trial, the judge who undertakes this scrutiny could not be the trial judge in order to avoid prejudice. If fee scrutiny takes place after settlement, judicial time would be spent in "costs-only" proceedings serving little substantive purpose, when the courts should be determining other cases on their merits.

7.15 It would be even more difficult to make a fair adjudication as to the ATE insurance premium. Lord Hoffmann in *Callery v Gray*[5] pointed out that ATE insurers did not compete on the premiums charged; instead, they competed for solicitors who would sell or recommend their insurance product. If the premiums were not paid either by the claimants who took out the insurance or by the solicitors who advised or required them to do so, market forces were insufficient to produce an efficient use of resources. The only restraining force on the premium charged was the amount that the costs judge would allow on assessment. It is Lord Hoffmann's view that the costs judge has no basis on which he can assess whether any given premium is reasonable.

Recommendation 3

Any success fee and ATE insurance premium agreed by the claimant with his lawyers and insurers respectively should not be recoverable from the defendant. The English provisions on recoverability of success fees and insurance premiums should not be followed.

Methods/criteria for fixing the success fee

7.16 Two concepts have to be borne in mind here: the "fixing" of the level of success fee and the "capping" of such fee. By the "fixing" of the success fee, we refer to the methodology/criteria for arriving at a percentage or a figure representing the success fee chargeable by a lawyer. In the absence of a prescribed methodology or formula (whether by reference to the chances of success of a case as assessed by the lawyer, and/or by reference to the type of case such as "simple running-down" or "complex commercial dispute", and/or by reference to the stage of the proceedings in question), the negotiation of the level of success fee will, in the first instance, be a matter entirely between the client and his lawyer. The only control would be by the court in assessing the reasonableness of the fee (if the client seeks to challenge the level of success fee charged by the lawyer). That would be unsatisfactory because of the court's unfamiliarity with market forces and commercial considerations as discussed in paragraph 7.14 above and in *Callery v Gray*. It will be our proposal that there should be some form of prescribed formula/methodology (or at least guidelines, binding or otherwise) governing the setting of the success fee.

7.17 On the other hand, the issue of "capping" of success fee relates to setting a maximum amount, beyond which the success fee cannot go, even if the success fee is agreed by the parties by reference to the prescribed methodology/formula. Logically, the issue of "fixing" should come before "capping" and we propose to discuss the two in this order.

[5] See discussion in Chapter 4, and para 4.33.

7.18 The English regulations do not specifically require the lawyer to fix the rate of success fee by reference to the risk of losing the case. The matter, in the first instance, is therefore left to the negotiations between the lawyer and his client. It has been suggested that the formula for calculating the success fee should be: (F ÷ S) x 100%, where F is prospects for failure and S is prospects of success. So, a case with a 75% prospect of success would attract a success fee of (25 ÷ 75) x 100% = 33.33%. The computation is obviously subjective and clients would not be in a position to evaluate the solicitor's assessment of the prospects of success.[6]

7.19 Given England's experience of conditional fees, it seems that part of the problem and reason for the spate of satellite litigation stems from the fact that the UK Government passed legislation to introduce conditional fee agreements without offering any guidance or Practice Directions as to the appropriate levels of success fee. In the English House of Lords case of *Callery v Gray*,[7] in the absence of authoritative guidance as to the appropriate level of success fee, a 60% success fee was agreed between the claimant and his solicitors in relation to a simple road traffic accident case. The trial judge reduced this to 40%, and the success fee was further reduced to 20% by the Court of Appeal. In *Halloran v Delaney*,[8] a success fee of 5% was thought to be appropriate for claims settled before the commencement of proceedings.

7.20 It is therefore advisable to involve interested bodies from the outset to see if common ground can be reached on the methodology and criteria for setting levels of success fee. In England, many millions of pounds in extra costs for disputing test cases through the Courts have been incurred. If a matrix of success fees (or methodologies for setting success fees), at least for straightforward cases, can be agreed from the outset in Hong Kong, uncertainties and disputes can be minimised.

7.21 In England, although the Civil Procedure (Amendment No 4) Rules 2003 have introduced a scheme of fixed costs for settled road traffic accident cases, the scheme did not fix the rate of success fees. Work is in progress to try and reach agreement on a pre-determined matrix of success fees that will apply in various situations, from simple road traffic accidents to more complex cases such as employers' liability. Overall, liability insurers are arguing that in many cases there is no risk of the claim failing and there should not be a success fee. A claim is deemed to have succeeded if some measure of damages is recovered, and this may in some cases be only a small percentage of the amount claimed. Initially, insurers often had to pay between 25% and 50% success fees, even in simple cases. The success fee is now often limited to 5% in straightforward "hit-in-the-rear" cases. Another source[9] indicated that there is industry-wide agreement that the appropriate figure for road traffic accident cases that settle pre-trial is 12.5% of base costs.

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6 J C Evans, England's New Conditional Fee Agreements, Defence Counsel Journal, July 1996 (63 Def Couns J 376)

7 See discussion in Chapter 4, and paras 4.2 – 4.29.

8 See discussion in Chapter 4, and paras 4.35 – 4.40.

9 Peysner, Fixing costs : settled RTA cases, NLJ 31 October 2003.

7.22 Lord Hoffmann in *Callery v Gray* also expressed the view that it would be more rational to have levels of success fee fixed by legislation instead of by the courts, as it was doubtful whether the courts would have the know-how to determine the reasonableness of a success fee. We agree with this approach.

7.23 The Sub-committee has also considered the English Court of Appeal's suggestion in *Callery v Gray* that the level of success fee should be fixed according to the stage of litigation, so that a two-stage success fee could be considered. The full success fee would be payable if the dispute reached the litigation stage, but there would be a reduction in the success fee if settlement were reached earlier. The Sub-committee agrees with the staged success fee approach and believes it should be adopted.

Recommendation 4

The method/criteria for fixing success fees should, as far as practicable, be fixed by legislation and should be determined by involving interested bodies including insurers, legal practitioners, and consumer bodies to see if common ground can be reached on reasonable methods and criteria for setting the level of success fees. The level of success fees should also be adjusted according to the stage of litigation, and staged success fees should be adopted.

Capping the success fee

7.24 In England, before conditional fees were introduced, the Lord Chancellor's Department suggested that the success fee should be restricted to 10% of normal costs. The Law Society of England & Wales argued that raising the success fee to 100% would enable a lawyer to break even if half of the cases taken on a conditional fee basis were successful. This Sub-committee believes that there is scope for capping the maximum success fee to less than 100%. It should be borne in mind that while normal costs consist of overheads and profits, any success fee is pure profit. Hence, a success fee of 100% does not only double the profits, but has multiplied profits by many times. In this regard, we beg to differ from the views expressed in *Sarwar v Alam*[10] in which a 100% success fee was justified if the issues were finely balanced. Over-inflated profits are unfair to the client, but also provide an incentive to legal practitioners to take on frivolous and speculative claims. That is detrimental to defendants and the judicial system and increases costs for society. We note that the success fee is capped at 25% in New South Wales and 50% in Queensland.

[10] [2003] EWHC 9001. See discussion in Chapter4, and paras 4.41 – 4.51.

7.25 Further, when the conditional fee regime was first introduced in England in 1995, the Law Society of England & Wales recommended that the solicitors' success fees should be capped at 25% of the damages recovered, while the Bar Council recommended that barristers' success fees should be capped at 10%. For the sake of proportionality, we believe the success fee should also be capped at a prescribed percentage of the damages recovered, and the percentage should be fixed by subsidiary legislation after consultation with the relevant bodies. This is to cater for the eventuality that the success fee, even if agreed by reference to the prescribed methodology/formula, may be completely disproportionate to the amount actually recovered. Take a case where by reference to the prescribed method, the success fee is set at 50% of the normal costs (because of, say, the lawyer's assessment of the risk involved) and normal costs amounted to $100,000. The claim amount is $500,000. The claimant succeeds (or the action is settled) and a sum of only $50,000 is recovered. According to the prescribed formula the client will have to pay a success fee of $50,000 (50% x $100,000) to his lawyer and he will not be able to recover this from the other side (because of our Recommendation 3). The undesirable end result is that his entire recovery will be eaten up by the success fee.

7.26 As to which of the two caps (ie the cap based on a percentage of normal costs, and the cap based on a percentage of the amount actually recovered) should take precedence, this should be left to be decided after consultation with the relevant bodies.

Recommendation 5

To discourage frivolous claims, there should be a cap on the success fee which is expressed as a percentage of normal costs. The cap should be fixed after consultation with interested bodies. It is the Sub-committee's view that there is scope for capping the maximum success fee at less than the 100% adopted in England. The success fee should also be capped at a prescribed percentage of the damages recovered.

Safeguards to protect defendants from nuisance claims

7.27 Under the existing rules, the fact that a claimant is risking his own money in pursuing litigation acts as a control on frivolous or nuisance claims. Under a conditional fee arrangement, a claimant is not liable to pay his own legal costs. Although he would be liable under the costs indemnity rule for the defendant's legal costs if the claimant's case is not successful, this may not be an effective deterrent to an impecunious claimant who is prepared

to take the risk of being adjudicated bankrupt for failing to pay the defendant's legal costs.[11]

7.28 The Sub-committee believes, therefore, that there should be some mechanism to safeguard defendants against nuisance claims. We suggest that a claimant utilising conditional fees should be required by law to notify the defendant of this fact and that the court should have discretionary power to require security for costs in appropriate cases. These requirements will have to be introduced by legislation. We believe these measures can maintain a healthy balance between the rights of claimants and defendants.

Recommendation 6

To protect the defendant from nuisance and frivolous claims, we recommend that a claimant utilising conditional fees should be required by law to notify the defendant of this fact and that the court should have discretionary power to require security for costs in appropriate cases.

Simple conditional fee agreements

7.29 We consider the requirements of the Conditional Fee Agreements Regulations 2000 in England are too complex and hence, open to technical challenges.[12] Full and frank information on all the terms and effects of a conditional fee agreement must be explained to the client, some orally, and the rest in writing. Failure to comply fully with these complex regulations can lead to invalidation of the conditional fee agreement. Not only plaintiffs have tried to challenge the validity of conditional fee agreements in courts, defendants are also challenging these agreements because if they could invalidate the arrangements between the plaintiffs and their lawyers, they could escape liability themselves due to the operation of the costs indemnity principle.

7.30 In order to avoid the proposed conditional fee regime in Hong Kong being plagued by satellite litigation, we believe the relevant regulations should be simple and easy to comply with. England has introduced a simpler version of standard conditional fee agreements, often referred to as "CFA Lite". The Sub-committee believes the regime in Hong Kong should also aim to be simple and user-friendly. England's Department for Constitutional Affairs has in its June 2004 consultation paper proposed to transplant client-care provisions from the relevant regulations[13] to the solicitors' practice rules as

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11 See for example discussion on *King v Telegraph Group Ltd* [2004] EWCA Civ 613, Hearing Date 18 May 2004.

12 See discussion in Chapter 3, para 3.76.

13 The Conditional Fee Agreements Regulations introduced in April 2000.

one of the means to further simplify the relevant regulations.[14] We believe similar measures should be adopted in Hong Kong.

Recommendation 7

The relevant legislation and subsidiary legislation should be simple and clear to avoid frivolous technical challenges. When drawing up relevant regulations for Hong Kong, reference should be made to the simplified version of conditional fee agreements introduced in England in 2003. Client-care provisions should be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies instead of the courts.

Policing the legal profession

7.31 If conditional fee agreements are considered as a viable alternative fee system, the policing of professional standards would be even more important than it is now. Because of the differences between Hong Kong and England, we should be slow to take comfort from statements in English reports and publications as to the lack of ethical problems brought about by the introduction of conditional fees.

7.32 There are professional bodies in place to monitor discipline, but the bodies have to be properly-resourced, and disciplinary proceedings have to be adjusted to take account of conditional fee agreements. There may be a need to respond quickly to complaints about conditional fee agreements which may arise at any stage of the litigation process.

7.33 Whatever the difficulties posed by policing the legal profession may be, the object must be to ensure that there is a system that is structurally sound. It will then be up to the governing councils of the professional bodies to provide the most effective means of policing the profession.

7.34 The relevant professional bodies may wish to review their professional conduct rules and to devise appropriate provisions in relation to conditional fee agreements to safeguard the interests of clients. The rules might include, for example:

- Specification that the decision to settle, and at what amount, should rest with the client.

[14] In August 2005, England's Department for Constitutional Affairs announced its intention to revoke the existing subsidiary legislation from November 2005, so that client care, contractual and guidance matters would be dealt with by the Law Society's professional rules of conduct and similar documents.

- Specification that the lawyer should at the outset clearly explain to his client the salient features of a conditional fee agreement and the likely financial implications upon the client should the case turn out to be unsuccessful.

- A requirement that the lawyer remind his client that he might be entitled to legal aid and to explain the differences between the conditional fee regime and legal aid.

- A requirement to draw up a standard CFA form safeguarding the basic interests of clients.

Recommendation 8

Given the aim to keep the legislation clear and simple, and to confine the necessary client-care provisions to the professional bodies' conduct rules, efforts should be made to ensure that the professional bodies adopt appropriate rules to safeguard clients' interests and have effective disciplinary measures to deal with and deter breaches of the relevant conduct rules.

Collective conditional fee agreements

7.35 After relaxation of the prohibitions against the use of conditional fees, some legal services providers and funders, including insurers and trade unions, may have a need to enter into collective conditional fee agreements,[15] that is, conditional fee agreements on a bulk basis. The purpose of collective conditional fee agreements is to ensure that providers and funders of large-scale legal services are not discouraged from using conditional fee agreements by administrative hurdles. For "normal" conditional fee agreements, the English legislation requires that each action must be supported by a separate conditional fee agreement. This requirement is relaxed for collective conditional fee agreements which can provide common terms for pursuing cases under the agreement, but the success fees for individual cases have to be specified. The relevant regulations[16] in England do not prescribe who can provide or use a collective conditional fee agreement.

7.36 In England, the requirements governing collective conditional fee agreements are contained in a separate set of regulations, although many of the requirements mirror those applicable to individual conditional fee agreements. Readers of the two sets of regulations have to compare them to identify the differences between the two types of conditional fee agreements.

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15 See discussion in Chapter 3, paras 3.59 – 3.61 above.

16 Collective Conditional Fee Agreements Regulations 2000, SI 2988.

The UK Department for Constitutional Affairs' Consultation Paper *Making simple CFAs a reality* issued on 29 June 2004 proposed that one set of regulations should be devised to cover both individual and collective conditional fee agreements.

7.37 The Sub-committee believes it will improve access to justice and reduce the administrative burden if bulk providers are allowed to enter into collective conditional fee agreements. Further, given the likely duplication of provisions in the regulations for individual and collective conditional fee agreements, it is sensible to formulate one set of regulations to cover both individual and collective conditional fee agreements. Practitioners and members of the public would find it easier to understand the differences between the two types of conditional fee agreements if the regulations identify which provisions apply to both types of conditional fee agreements, and which provisions apply only to collective conditional fee agreements.

Recommendation 9

Regulations should be drawn up to enable those engaged in the provision or purchase of legal services *en masse* to make use of collective conditional fee agreements. The proposal in the June 2004 Consultation Paper issued by the UK Department for Constitutional Affairs to devise one set of regulations to cover both individual and collective conditional fee agreements should be adopted in Hong Kong.

Types of event-triggered fees to be validated

7.38 In England, section 58 of the Courts and Legal Services Act 1990, as it was in force before 1 April 2000, defined a conditional fee agreement as "*an agreement with a person providing advocacy or litigation services which provides for his fees and expenses, or any part of them, to be payable only in specified circumstances.*"[17] However, the relevant provisions did not clearly spell out which specific types of event-triggered fees should be allowed. Section 58(1) of the Courts and Legal Services Act 1990 validated conditional fee agreements by providing that a conditional fee agreement shall not be unenforceable by reason only of its being a conditional agreement, providing it satisfied all the other requirements of the section, which included conditions specified in Regulations under section 58(3)(c). The Solicitors' Practice Rules at that time stated, "*A solicitor who is retained or employed to prosecute any action, suit or other contentious proceeding shall not enter into any arrangement to receive a contingency fee in respect of that proceeding …* ." A contingency fee was defined in the Practice Rules as "*any sum (whether*

[17] Section 27 of the Access to Justice Act 1999 substitutes s 58 of, and inserted ss 58A and 58B into, the Courts and Legal Services Act 1990.

fixed, or calculated either as a percentage of the proceeds or otherwise howsoever) payable only in the event of success in the prosecution or defence of any action, suit or other contentious proceeding." Given this definition, contingency fees (prohibited by professional conduct rules) are not limited to cases in which a solicitor takes a percentage of the award.

7.39 The Access to Justice Act 1999 and the Conditional Fee Agreements Regulations 2000 recognised and approved the use of conditional fee arrangements such as were used in the *Thai Trading* and *Bevan Ashford* cases. By 2000, conditional fee arrangements which were legitimised included:

(a) No win, no fee; if win, success fees;
(b) No win, no fee; if win, normal fees;[18]
(c) No win, reduced fee; if win, normal fees;[19] and
(d) No win, reduced fee; if win, success fees.

7.40 The Sub-committee believes that the specific types of approved conditional fee arrangements should be clearly set out in the proposed legislation to avoid any uncertainty, cross referencing to different regulations and professional conduct rules, and unnecessary litigation. Otherwise, the string of litigation in England (as in *British Waterways Board v Norman*, *Thai Trading Co v Taylor*, and *Awwad v Geraghty & Co*) may be repeated in Hong Kong. Further, the Sub-committee believes the following types of conditional fee arrangements should not be allowed:

(a) No win, unspecified fee; if win, success fee;[20]
(b) No win, normal fee; if win, success fee.

7.41 As for other forms of event-triggered fees, including contingency fees, the Sub-committee believes that a lawyer should remain a provider of professional services and should charge professional fees only. The Sub-committee considers that the American version of contingency fee, in which lawyers take a percentage of the damages awarded, gives lawyers too much of a direct personal financial interest in the litigation, and the Sub-committee reject that option.

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18 As in *British Waterways Board v Norman*.
19 As in *Aratra Potato Co Ltd v Taylor Joynson Garrett*, and *Awwad v Geraghty & Co*.
20 As in *Hughes v Kingston Upon Hull City Council* [1999] 2 All ER 49.

Recommendation 10

To avoid unnecessary litigation on whether a particular type of event-triggered fee is or is not valid, or against professional conduct rules or public policy, the proposed legislation should spell out the specific types of conditional fee arrangements allowed under the proposed conditional fee regime. These should be:

(a) No win, no fee; if win, success fees;
(b) No win, no fee; if win, normal fees;
(c) No win, reduced fee; if win, normal fees; and
(d) No win, reduced fee; if win, success fees.

Other forms of event triggered fees, including contingency fee arrangements, should continue to remain unlawful as being contrary to public policy.

Insurance

7.42 In a jurisdiction which adopts the costs indemnity rule[21] such as ours, a conditional fee regime can work effectively only if ATE insurance is available. Otherwise, a claimant may still be deterred from bringing proceedings by the risk of an adverse costs order if he fails in his claim. From the information made available to the Sub-committee, ATE insurance may or may not be available on a long-term basis in Hong Kong. Even assuming its availability, there is no guarantee that the premiums for ATE insurance can be kept at an affordable level.

7.43 In England, a one-off premium of £85 would buy £100,000 of coverage in 1995 in respect of the other side's costs and the client's expert fees and certain disbursements. By August 2004, the premium for the same coverage for a road traffic accident case was £375. The premiums for occupational disease claims and other types of claims were £1,175 and £815 respectively.[22] In simple personal injury cases, the insurance premium in England now comes close to the likely costs of an undefended action. In S*arwar v Alam*[23] the costs judge allowed an ATE premium of £62,500 for cover of £125,000 because the claimants' solicitors had difficulty finding a standard insurance policy on the market, and a "tailor-made" insurance policy had attracted a substantially higher premium.

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21 This means that the unsuccessful litigant will usually be ordered by the court to pay the legal costs of the successful party.

22 See Chapter 3 under heading 'After-the-Event Insurance'. Litigation Funding, Aug 2004 Issue 32 at 10.

23 [2003] EWHC 9001 – See discussion in Chapter 4, and paras 4.48 – 4.51.

Recommendation 11

As the feasibility of a conditional fee regime depends upon whether there is insurance available to cover the opponent's legal costs if the claim is unsuccessful, the Administration should conduct an in-depth study of the commercial viability of ATE insurance in Hong Kong.

Expansion of SLAS

7.44 Given that it is uncertain whether ATE insurance will be available in Hong Kong on a long-term basis at an affordable premium, the Sub-committee has considered the possibility of expanding the Supplementary Legal Aid Scheme ("SLAS"). SLAS is a self-financing scheme funded by contributions paid by the applicant upon acceptance of legal aid, as well as contributions deducted from any compensation recovered in the court proceedings.[24] SLAS is operated effectively on a contingency fee basis by the Legal Aid Department and is free from the problems of contingency fees administered by private practitioners in American jurisdictions. SLAS is supported by litigants and legal practitioners, and is generally considered a success.

7.45 The Sub-committee believes that consideration should be given to expanding SLAS by increasing its financial eligibility limits, and by expanding the types of cases which are covered by SLAS.

Recommendation 12

Given the success of the Supplementary Legal Aid Scheme in widening access to justice by using event-triggered fees on a self-financing basis, consideration should be given to expanding SLAS on a gradual incremental basis, by raising the financial eligibility limits and by increasing the types of cases which can be taken up by SLAS.

Setting up of a privately-run contingency legal aid fund

7.46 Since it is uncertain whether SLAS can be expanded, and if so to what extent, the Sub-committee has explored the idea of setting up an independent body which screens applications to use event-triggered fees, finances the litigation, and takes a share in the compensation in successful cases, and also pays the defendants' legal costs in unsuccessful cases. This

[24] See Chapter 1 above.

body (which would likely to be statutory) would not operate for profit, but would be self-financing from its share of compensation in successful cases. It would, however, require the provision of the necessary initial "seed" funding. This new scheme would be separate and different from SLAS in that applicants would not be means-tested, but would have to pass the merits test.

7.47 This idea is similar to the "Contingency Legal Aid Fund" ("CLAF") proposed by the English Bar, which suggested that there should be no financial eligibility test, hence providing access to justice to those ineligible for legal aid. Successful plaintiffs would pay an agreed proportion of their winnings into CLAF which would be utilised to meet the cost of unsuccessful cases. It was envisaged that CLAF would run alongside conditional fee agreements, and would compete for cases being charged under conditional fee arrangements. The English Bar conducted a preliminary feasibility study which found that CLAF could be self-financing but might need a start-up loan from the Government. The English Bar had hoped that CLAF would cover a wide range of cases, but the feasibility study suggested that, for a CLAF to be financially viable, it would have to concentrate on the categories of litigation with high success rates and with good damages to costs ratio. This means largely personal injury actions. The feasibility study had not included in its analysis other damages and contract cases.

7.48 In fact, a CLAF was first suggested as an alternative means of funding legal aid as long ago as 1966 by Justice (British Section of the International Commission of Jurists).[25] The UK Government rejected this proposal on several occasions[26] for various reasons, in particular the substantial initial cost of setting up a fund and doubts over the ability of the fund to be self-financing.[27] Further reasons for not taking on the English Bar's proposal for CLAF are:

- CLAF would only support plaintiffs who are claiming relatively large sums of money.
- There is a danger that plaintiffs with good prospects of success would choose not to use the scheme, but those with a poor case would seek to do so, thus putting the financial viability of the scheme in jeopardy.
- It would be wrong to expect successful clients to subsidise those who were unsuccessful.
- There would be public disappointment if the scheme failed to give assistance to what were regarded as deserving cases, for example when the plaintiff's case attracted strong sympathy but the prospects of the case were not strong.

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25 UK Department for Constitutional Affairs, "Making simple CFAs a reality", 29 June 2004 at para 58.

26 CLAF was rejected by the Legal Advisory Committee on Legal Services in its 28th report, and the Benson Report in 1978. Proposals for a CLAF were again submitted for the Legal Aid Bill 1988 and the Courts and Legal Services Bill 1990.

27 UK Department for Constitutional Affairs, cited above, at para 58.

- If deficiencies occurred, there would be a drain on public funds.

7.49 Despite the reluctance of the UK Government to set up a CLAF, it was made clear that the Government would have no objection if the legal profession or another private organisation wished to set up its own privately-funded CLAF.[28] In fact, section 28 of the Access to Justice Act 1999, which has not yet been brought into effect, does provide a statutory basis for a third party to establish a CLAF. The provision was included in the Act as a reserve power in the event that conditional fee agreements or other forms of funding litigation could not adequately improve access to justice. The English Bar Council has recently suggested a slight modification in response to the 2003 consultation exercise by the UK Department for Constitutional Affairs. The English Bar Council now proposes the establishment of a CLAF underwritten by a private finance initiative.[29] This is in line with the English Bar Council's "*traditional objection to contingent fee arrangements and its long-standing preference, in the absence of legal aid, for a publicly funded CLAF".*[30]

7.50 The Sub-committee believes that concerns relating to the setting up of a CLAF have not been borne out by the experience of SLAS (which can be viewed as a form of CLAF administered by the Government), and such a scheme is unlikely to be overly problematic. We believe members of the public would rather have an additional choice of funding enabling them to access the courts. This option allows widened access to justice at relatively little cost to the public purse, save some start-up money. Even if the ATE insurance market becomes unstable or (in a worst case scenario) unavailable, a private contingency legal aid fund would still be able to utilise event-triggered fees to widen access to justice. The risk of the unavailability of ATE insurance (which may strike at the very heart of privately agreed conditional fee agreements), and the lack of certainty that SLAS will be expanded, in fact formed an important consideration behind our thinking that such a separate private body be set up to administer cases on an institutionalized basis.

7.51 The Sub-committee further proposes that a conditional fee element can be built into the proposed privately-run scheme in that, whilst the proposed scheme charges the client a contingency fee, the private lawyers accepting instructions from the scheme are paid on a conditional fee basis. In that way, private lawyers will have an additional financial incentive to complete cases expeditiously and to the best of their ability. As our proposed scheme has both conditional and contingency fee features, we will refer to it as "the hybrid model".

7.52 As for the relationship between SLAS and the hybrid model, on the assumption that Recommendation 12 for the expansion of SLAS is not implemented, the Sub-committee proposes that SLAS (means-tested) under the Legal Aid Department should co-exist with the hybrid model (not

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28 As above, at para 60.

29 As above, at para 61.

30 As above.

means-tested) which is administered independently. There will be some overlap in their scope, and we acknowledge that the public will require very clear explanation as to the function of such a scheme to avoid confusion with SLAS and any conditional fee arrangements to be legitimised. However, on balance, we believe that the public would benefit from increased choice.

Recommendation 13

Consideration should be given to setting up an independent body to screen applications for the use of event-triggered fees, to brief out cases to private lawyers, to finance the litigation, and to pay the opponent's legal costs should the litigation prove unsuccessful. Applicants under the scheme would not be means-tested but applications would have to satisfy the merits test. The proposed body would take a share of the compensation recovered, while the private lawyers would be paid on a conditional fee basis. Litigants with a good case would therefore have access to the courts without financial exposure, even if ATE insurance was not available and SLAS was not expanded.

Observations

7.53 The abolition of champerty and maintenance as crimes in England have led to the proliferation and, in some cases, the sudden collapse of claims intermediaries. The relevant authorities may wish to consider whether there is a need to regulate claims intermediaries in Hong Kong. If left unregulated, the proliferation and sudden collapse of claims intermediaries may be replicated in Hong Kong, and claims intermediaries may merely add cost without adding value to the claims process.

Conclusion

7.54 The Sub-committee believes that, if properly formulated and regulated, conditional fee agreements can play a pivotal role in widening access to justice. It is crucial that any proposed scheme should strike a fair balance between protecting both defendants' and claimants' interests. The Sub-committee's proposals have accordingly been structured to discourage frivolous claims but to ensure those with a genuine claim can exercise their rights swiftly, and at minimum cost to them and to society.

Chapter 8

Summary of recommendations

(All the recommendations in this paper are to be found in Chapter 7)

<u>Recommendation 1</u> : Should we allow conditional fees? (paragraphs 7.1 – 7.3)

Prohibitions against the use of conditional fees in certain types of civil litigation by legal practitioners should be lifted, so that legal practitioners may choose to charge conditional fees in appropriate cases.

<u>Recommendation 2</u> : Types of cases for conditional fee agreements (paragraphs 7.4 – 7.9)

The proposed conditional fee regime should apply to the following types of cases:

- personal injury cases;
- family cases, except where the welfare of children is involved;
- commercial cases in which an award of damages is the primary remedy sought;
- product liability cases;
- probate cases involving an estate;
- insolvency cases;
- employees' compensation cases; and
- professional negligence cases.

We believe the conditional fee regime should not apply to criminal cases, family cases involving the welfare of children, defamation cases and cases in which an award of damages is not the primary remedy sought.

<u>Recommendation 3</u> : Recoverability of insurance premium and success fee from the unsuccessful party (paragraphs 7.10 – 7.15)

Any success fee and ATE insurance premium agreed by the claimant with his lawyers and insurers respectively should not be recoverable from the defendant. The English provisions on recoverability of success fees and insurance premiums should not be followed.

Recommendation 4 : Methods/criteria for fixing the success fee (paragraphs 7.16 – 7.23)

The method/criteria for fixing success fees should, as far as practicable, be fixed by legislation and should be determined by involving interested bodies including insurers, legal practitioners, and consumer bodies to see if common ground can be reached on reasonable methods and criteria for setting the level of success fees. The level of success fees should also be adjusted according to the stage of litigation, and staged success fees should be adopted.

Recommendation 5 : Capping the success fee (paragraphs 7.24 – 7.26)

To discourage frivolous claims, there should be a cap on the success fee which is expressed as a percentage of normal costs. The cap should be fixed after consultation with interested bodies. It is the Sub-committee's view that there is scope for capping the maximum success fee at less than the 100% adopted in England. The success fee should also be capped at a prescribed percentage of the damages recovered.

Recommendation 6 : Safeguards to protect defendants from nuisance claims (paragraphs 7.27 – 7.28)

To protect the defendant from nuisance and frivolous claims, we recommend that a claimant utilising conditional fees should be required by law to notify the defendant of this fact and that the court should have discretionary power to require security for costs in appropriate cases.

Recommendation 7 : Simple conditional fee agreements (paragraphs 7.29 – 7.30)

The relevant legislation and subsidiary legislation should be simple and clear to avoid frivolous technical challenges. When drawing up relevant regulations for Hong Kong, reference should be made to the simplified version of conditional fee agreements introduced in England in 2003. Client-care provisions should be set out in professional codes of conduct so that trivial breaches can be dealt with expeditiously by the professional bodies instead of the courts.

Recommendation 8 : Policing of the profession (paragraphs 7.31 – 7.34)

Given the aim to keep the legislation clear and simple, and to confine the necessary client-care provisions to the professional bodies' conduct rules, efforts should be made to ensure that the professional bodies adopt

appropriate rules to safeguard clients' interests and have effective disciplinary measures to deal with and deter breaches of the relevant conduct rules.

Recommendation 9 : Collective conditional fee agreements (paragraphs 7.35 – 7.37)

Regulations should be drawn up to enable those engaged in the provision or purchase of legal services *en masse* to make use of collective conditional fee agreements. The proposal in the June 2004 Consultation Paper issued by the UK Department for Constitutional Affairs to devise one set of regulations to cover both individual and collective conditional fee agreements should be adopted in Hong Kong.

Recommendation 10 : Types of event-triggered fees to be validated (paragraphs 7.38 – 7.41)

To avoid unnecessary litigation on whether a particular type of event-triggered fee is or is not valid, or against professional conduct rules or public policy, the proposed legislation should spell out the specific types of conditional fee arrangements allowed under the proposed conditional fee regime. These should be:

(a) No win, no fee; if win, success fees;
(b) No win, no fee; if win, normal fees;
(c) No win, reduced fee; if win, normal fees; and
(d) No win, reduced fee; if win, success fees.

Other forms of event triggered fees, including contingency fee arrangements, should continue to remain unlawful as being contrary to public policy.

Recommendation 11 : Insurance (paragraphs 7.42 – 7.43)

As the feasibility of a conditional fee regime depends upon whether there is insurance available to cover the opponent's legal costs if the claim is unsuccessful, the Administration should conduct an in-depth study of the commercial viability of ATE insurance in Hong Kong.

Recommendation 12 : Expansion of SLAS (paragraphs 7.44 – 7.45)

Given the success of the Supplementary Legal Aid Scheme in widening access to justice by using event-triggered fees on a self-financing basis, consideration should be given to expanding SLAS on a gradual incremental basis, by raising the financial eligibility limits and by increasing the types of cases which can be taken up by SLAS.

<u>Recommendation 13</u> : Setting up of a privately-run contingency legal aid fund (paragraphs 7.46 – 7.52)

Consideration should be given to setting up an independent body to screen applications for the use of event-triggered fees, to brief out cases to private lawyers, to finance the litigation, and to pay the opponent's legal costs should the litigation prove unsuccessful. Applicants under the scheme would not be means-tested but applications would have to satisfy the merits test. The proposed body would take a share of the compensation recovered, while the private lawyers would be paid on a conditional fee basis. Litigants with a good case would therefore have access to the courts without financial exposure, even if ATE insurance was not available and SLAS was not expanded.