“Improving Access to Justice”

Contingency Fees

A Study of their operation in the United States of America

A Research Paper informing the Review of Costs

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<table>
<thead>
<tr>
<th>Chapter</th>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part 1 - Key Findings</td>
<td>Key Findings 1 - 11</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Catastrophic failure</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>Proportionality</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Transaction Costs</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>Access to Justice – Good claims and weak claims</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td>The Americanisation problem</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Lack of an incentive to settle problem</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>What would an alternative look like?</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>What level of uplift should be permitted</td>
<td>23</td>
</tr>
<tr>
<td></td>
<td>Recoverable contingency fees?</td>
<td>25</td>
</tr>
<tr>
<td></td>
<td>Simplicity and the consumer</td>
<td>25</td>
</tr>
<tr>
<td></td>
<td>Do we need to move to contingency fees now?</td>
<td>27</td>
</tr>
<tr>
<td></td>
<td>Return to pre Access to Justice Act CFA Model</td>
<td>28</td>
</tr>
<tr>
<td></td>
<td>Abolition of the English Costs Rule</td>
<td>28</td>
</tr>
<tr>
<td></td>
<td>Introduce one way cost shifting</td>
<td>31</td>
</tr>
<tr>
<td></td>
<td>Introduce a mixed system</td>
<td>32</td>
</tr>
<tr>
<td></td>
<td>Conclusions</td>
<td>35</td>
</tr>
<tr>
<td>ANNEX A</td>
<td>Glossary</td>
<td>37</td>
</tr>
<tr>
<td>ANNEX B</td>
<td>Bibliography</td>
<td>38</td>
</tr>
</tbody>
</table>

Contingency Fees – Moorhead and Hurst
Contingency Fees

A Study of their operation in the United States of America

INTRODUCTION

1. Following the publication of the Civil Justice Council’s Paper “The Future Funding of Litigation – Alternative Funding Structures” (June 2007) further research has been carried out into the contingency fee system used in the United States of America. This further research was necessitated partly by the findings of the Civil Justice Council in its Report:

“Recommendation 4: In multi party cases where no other form of funding is available, regulated contingency fees should be permitted to provide access to justice. The Ministry of Justice should conduct thorough research to ascertain whether contingency fees can improve access to justice in the resolution of civil disputes generally.”
2. In addition to the above recommendation there is a perception in this jurisdiction that the level of challenges generated by the recoverability of success fees in conditional fee agreements (CFA) and recoverable premiums in respect of after the event insurance (ATE) policies has meant that the ATE market continues to experience difficulties in its establishment.¹ That view is contested by some. It is not necessary to resolve that question here, because the Council recognise the importance of developing policy in this field in case the doubts about long term viability of ATE are realised.²

3. The Master of the Rolls has also expressed his concerns:

"There has historically been no great appetite within the DCA to conduct a study of contingency fees. This is a pity because I think there is considerable merit in an independent study establishing a comprehensive and informed view on the operation of contingency fees in the USA. The time may be coming when some form of contingency fee will be seen as desirable in England and Wales. In these circumstances there is I think, a real need for such a study in order that we may understand what benefits contingency fees may bring to improving access to justice, and what lessons there are to learn from their operation in the United States. In these circumstances I hope that the MoJ will support this project".

¹ See CJC Report paragraph 169.

² This was most recently addressed in the Claims Process Consultation Paper, published by the Ministry of Justice. In their response, the ministry reported that 20% of respondents expressed the view that the ATE market might collapse against proposed reforms to the personal injury system to remove ATE insurance from cases that settle. 20% thought the ATE market would adapt to changes. 40% predicted considerable increases in ATE premiums if proposals in the consultation paper were adopted. The ministry has announced it will not be taking forward the proposal.
4. The Civil Justice Council remains committed to the overriding principles published previously.\(^3\) These principles state that the delivery of access to justice is dependent upon:

i. a meritorious case;

ii. the participants having at the outset access to means of funding their case;

iii. the lawyers on each side having at the outset access to reasonable remuneration;

iv. the cost of (ii) and (iii) being proportionate to what is at stake; and,

v. the availability of an efficient and properly resourced civil justice system.

Alternatives to Conditional Fee Agreements

5. This report considers alternatives to the current system of Conditional Fee Agreements (CFAs) and in particular the implications of adopting damages-based Contingency Fees as an alternative should CFAs fail. It does so following detailed research undertaken by Senior Costs Judge Peter Hurst and Professor Richard Moorhead into the operation of contingency fees in the USA.

\(^3\) E.g., *The Future of Litigation Funding – Alternative Funding Structures*, (CJC) (June 2007) at 7.
6. Although CFAs are, in fact, a species of contingency fee, this report uses the term Contingency Fee to refer to **damages-based contingency fees**. Under a damages based contingency fee system, a lawyer is paid nothing if the case is lost, and a percentage of any damages recovered for a claimant if s/he wins. Normally the fee is paid out of the claimant’s damages, but it is possible for it to be paid by the unsuccessful defendant. Conditional Fee Agreements are somewhat more complicated. Typically, claimant lawyers are (usually) paid nothing if they lose a case but if they win they are paid a base fee (the number of hours reasonably spent multiplied by their normal hourly rate) plus a success fee (which is a percentage of the base fee).

7. Conceptually, the success fee is compensation for the risk claimant lawyers bear in taking on a case for which they might not get paid if they lose. Success fees can be anything up to 100%, although in some cases success fees are regulated by industry wide agreements (see CPR Part 45 Sections II – V). The courts retain the power to reduce success fees in unregulated cases if they are found to be unreasonable.

8. Because of the costs rules in England and Wales, CFAs are currently supported by a system of **After the Event (ATE) Insurance** which covers the claimants’ risk of paying their opponent’s costs should they lose.

9. Under the current system, the insurance premium is recoverable if the claimant is successful. Often, payment of the insurance premium is deferred so that it is payable in the event of success only. It may also be self insured so that nothing is payable if the case is lost. In this way claimants often do not have to pay for the insurance that they take out. Nor is it compulsory to take out ATE insurance. Similarly, the success fee
is recoverable from the losing party. Hence the defendant insurers typically pay base costs, success fee and ATE insurance premium whenever they lose a case.
KEY FINDING 1 –

(Should CFA’s fail) Contingency fees, either with or without costs shifting could operate effectively in the England and Wales jurisdiction. Access to justice may narrow, particularly for lower value cases; conversely it may broaden for multi-party and higher value cases.

A contingency fee system could not be directly transplanted from the United States, or any Canadian jurisdiction, without further detailed consideration of processes and consequences, however there is considerable confidence that a contingency fee system in England and Wales is viable albeit with some risk of diminution in overall levels of access to justice for claims where the main remedy is compensation.
KEY FINDING 2 -

Contingency fees without cost shifting would provide a cleaner and less complicated model for England and Wales, which would remove the vast majority, if not all of the technical costs challenges, depending on precise design. Transactional costs in personal injury claims would be reduced significantly in a contingency fee system.

Contingency fees without costs shifting would remove the need for summary and ex post facto costs assessment, and would thus abolish technical costs challenges from defendants. There would be merits, however, in having a degree of costs recovery associated with contingency fees, e.g. associated with part 36 offers (see below).

KEY FINDING 3 -

Contingency fees in the United States regularly include some element of costs shifting, particularly in shifting disbursements and other costs against the losing party.

There are also around two hundred statutes in the US that provide for cost shifting of attorneys fees.
KEY FINDING 4 -

Contingency fees in the United States are generally not extravagant.

Contingency fees tend to gravitate toward 33%, although there are some agreements where rates are lower and staging of percentages related to the stage at which a case is resolved (e.g. pre-issue, post-issue, at trial). Contingency fee rates rarely if ever exceed 50%.4

KEY FINDING 5 -

The fixing of contingency fees is largely unregulated, although there is also some statutory regulation through caps on percentage fees in some States, particularly for medical malpractice and ‘lodestar’ cross checks in class action claims.

Lack of regulation prompts some concerns about windfall fees where the level of contingency fee dramatically exceeds the level of effort a lawyer expends on a case. Similarly, concerns are sometimes expressed that percentage deductions from a claimant’s damages seem excessive on the facts of a particular case (because of subrogation issues, for instance which would reduce the client’s damages to zero). There is some evidence that claimant lawyers modify percentage deductions in the client’s favour to prevent damage to their reputations in the latter kinds of situation.

Although, there is some secondary litigation in class actions where claimant lawyers are sued by a second set of lawyers to reduce their percentage payments, there is a surprising absence of evidence of consumer disquiet about contingency fees. Equally, there is very little evidence of market forces reducing contingency fee percentages, save perhaps in class actions. Claimants do not generally seem to shop around on this basis.

KEY FINDING 6 -

Regulation of contingency fees through caps would be likely to both reduce the level of overcharging and reduce access to justice (there is clear evidence that such caps reduce the number of cases brought).

There is relatively clear evidence that imposing caps on contingency fees impacts on the number of cases brought and the way in which they are handled reducing access to justice for claimants.

KEY FINDING 7 -

Lower value and high risk injury claims are brought in the United States.

Lawyers tend to cross-subsidise lower value claims through contingency fee recoveries in larger cases, on a swings and roundabouts basis, in similar vein to success fees in England and Wales. High volumes support the system. There is also a segmentation of the market between those specialising in higher value, higher risk claims and more standard work. There is cross-subsidy between these suppliers through contingency based referral fees which partly incentivise quality.
Lower value claims in low volume work, however, are affected detrimentally, with lawyers not bringing non profitable claims. Contingency fees in larger cases may sometimes be disproportionate, but they fulfil a wider social function in promoting access to justice in the smaller cases. Cross subsidy also allows lawyers to bring higher risk cases, for example in medical malpractice cases up to 70% of cases that are brought may fail. A key unknown is the extent to which this cross-subsidy depends on the higher value damages in high value cases in the United States.

KEY FINDING 8 -

There appears to be no strong evidence that contingency fees provide improper disincentives to settle. Contingency fees can operate efficiently with a system similar to Part 36 offers.

Contingency fees are likely to lead to some incentives to settle earlier than in conditional fee or hourly rate cases. At some point the benefit to a lawyer in pushing for an increased settlement is outweighed by the cost and risk that they will incur in pushing further. Whilst this may sometimes conflict with what is in the client’s interests, it is a conflict which is generally likely to occur at the margins and should be consistent with the need to resolve disputes proportionately. There are also contrary pressures on the lawyer such as the need to maintain their reputation for being ‘hard bargainers’ with clients and, importantly, with Defendants.

Even with no general ‘loser pays’ costs rules, experience in the US has shown that offers of settlement, analogous to Part 36 offers, and which
carry similar costs shifting, work even to the extent that they may speed up settlement without reducing the compensation paid to claimants.5

KEY FINDING 9 -

Levels of damages are reportedly much higher in the USA than in England and Wales

Such levels of damages may support a greater level of cross-subsidy than would be the case in the UK and wider access to justice than could be achieved here. The claim, often made, that damages claims have become inflated to reflect the contingency fee is not supported by any robust empirical evidence that we are aware of. Were such an effect to take place, it may still be less costly and more proportionate than the current CFA system.

KEY FINDING 10 –

Damages-based contingency fees typically operate on the basis that the claimant’s damages are reduced by the lawyer’s fee.

A substantial concern, although not one often voiced in the United States debates, is that deductions from compensation are a significant detriment to claimants at a time of substantial need. An alternative approach, would be to permit recoverability of contingency fee percentages to a fixed level (say 25-33%). Such costs recovery may necessitate the retention of ATE and give rise to issues surrounding that.

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KEY FINDING 11 -

Contingency fees do not appear to promote high rates of litigation, frivolous claims, or a litigation culture.

The most robust comparison of which we are aware, and which pre-date the introduction of CFAs here, suggests that whilst Americans are more likely to consider claiming than in England and Wales, they are not more likely to seek legal assistance in making a claim. Headline levels of damages and jury awards in particular provide the strongest explanation for concerns about the United States system, not contingency fees.

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PART 2
RESEARCH FINDINGS

Key concerns with the System in England and Wales

10. The Council’s recommendation in the June 2007 report that greater consideration be given to contingency fees was motivated by three main concerns:

- the potential that the current CFA system could collapse (the catastrophic failure problem);
- that the level of costs associated with personal injury claims in general is too high (the disproportionality problem); and,
- that certain types of claim are poorly served by CFAs because incentives to take the claims under CFAs are not sufficient to outweigh the risks of proceeding (the access to justice problem).
The Risk of Catastrophic Failure

11. The catastrophic failure problem, as we noted in a previous report, is based on the following concerns:

“the CJC believes that a combination of; adverse market behaviour, susceptibility to technical court challenges on levels of ATE premium, high referral fees, and the potential impact of Government proposals for the reform of the personal injury claims process mean that the stability of the ATE market is vulnerable with a consequence on CFAs. Should any one or a combination of these effects reduce ATE coverage, CFA’s may fail as a result. It follows that in the absence of legal aid, contingency fees may need to become a mainstream funding alternative.”

12. There appear to be four underlying reasons for challenges to Conditional Fee Agreements:

- challenges to the validity of CFAs on the basis of claimant lawyer failures to satisfy the technical requirements of a valid CFA;

- the absence of a genuine market regulating the size of uplifts and ATE premiums may mean that insurance premiums and success fees are too high;

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7 Paragraph 169 - “Improved Access to Justice – Funding Options & Proportionate Costs” The Future Funding of Litigation - Alternative Funding Structures. The risk as stated earlier has now diminished a a certain degree with the Ministry of Justice deciding not to take forward proposals to remove ATE insurance from settled PI claims
● success fees and insurance premiums have substantially increased the transaction costs of personal injury claims;

and,

● either because of the size of that increase, or for principled reasons, the recoverability of success fees and insurance premiums is regarded as wrong by the insurance industry. In particular, because success fees and insurance premiums cover the claimant or the claimant solicitor’s risk, not their own risk.

13. With regard to the fourth point, defendant insurers spread the costs of recoverability amongst their insured; the many pay for the few. This has a ‘polluter pays’ logic to it. Each potential polluter (a potential tortfeasor who takes out insurance) is liable for the costs of supporting the access to justice system. In motor insurance, for example, the insured is both funder (polluter) and potential beneficiary of the system (in so far as they have access to justice should they suffer loss).

14. Furthermore, whilst ATE provides a key protection to claimants which, given the costs rules, is necessary to ensure valid claims are brought, ATE also has brought a new, and significant, benefit to defendants. That benefit is a significant economic incentive to litigate cases they believe they can win. In other words, ATE provides key benefits to both parties but at a significant cost.
Are contingency fees an effective insurance policy for funding civil claims should other systems become non viable?

Proportionality

15. A key benefit of contingency fees is that they ensure that claimant lawyer costs are directly proportionate to any compensation that is paid. A system which delivered personal injury cases at a contingency fee of (say) 33% would be more proportionate than the current system, certainly for the bulk of smaller claims. This would be true whether or not the contingency fee was paid by the claimant or the defendant.

16. An obvious concern that this might engender is the extent to which small cases (which make up the bulk of civil justice claims at the minute) would be squeezed out by contingency fees because such cases are uneconomic. Some might argue that this is desirable: if proportionality as a concept is to have real purchase then smaller claims should be squeezed out of the system and/or pursued in different ways.

17. In the US system, there is some squeezing out – with smaller cases sometimes being taken on a ‘settlement only’ basis (i.e. lawyers try to negotiate settlements quickly and either succeed or drop the cases) and cases which technically meriting higher damages being submitted on a more modest basis to come within small claims jurisdictions.

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8 See, for example, ABI (2008) *Adding Insult to Injury: the need for reform of the personal injury compensation system* (London: ABI) page 4
18. Nevertheless, Kritzer shows that in the mid-90s typical contingency fee cases appeared to involve recovery of between $10,000 and $30,000. With half of all cases producing a fee of less than $5,000.\(^9\) There is also established a practice of cross-subsidy by plaintiff lawyers. That is, plaintiff lawyers are willing to take on large numbers of less, or unprofitable cases to ensure that they get a small stream of larger more profitable claims.\(^10\)

19. The redistributive element to contingency fees also hints at a perceived problem. That is, the concern that larger value cases can give rise to a contingency fee disproportionate to the lawyer’s effort. Various jurisdictions in the United States have sought to regulate this in a variety of ways, through regulating the level of contingency fees that can be charged in higher value cases (reducing the percentage chargeable as damages increase) and through encouraging cross-checking of contingency fees against hourly equivalents through a lodestar calculation.\(^11\)

20. A balance needs therefore to be struck between access to justice, the efficiency/simplicity of any scheme (to avoid ex post facto assessment of costs and/or challenges to the percentage fees charged) were contingency fees recoverable and/or the capacity for exploitative charging.

\(^9\) Kritzer cited note 4 page 37


\(^11\) These approaches impact on fees but are sometimes questionable on efficiency grounds because the effort that goes into working out the right level of fee is greater than the difference between the ‘right’ fee and the contingency fee. See, Miller Geoffrey P. and Theodore Eisenberg (2005), Attorney Fees in Class Action Settlements: An Empirical Study, New York University Law and Economics Working Papers, Paper 2.
21. It follows from the above description that contingency fees have the potential to reduce significantly the transaction costs of litigation both in terms of reducing the actual costs of litigation and reducing the costs associated with calculating and/or challenging base costs (bills are calculated by reference to compensation paid not by a detailed itemisation of work done).

Access to Justice - Good Claims and Weak Claims

22. It is clear that in the US, contingency fees support a level of litigation that does not exclude a significant proportion of the small cases that are the staple of any mass civil justice system and also does not only operate in areas of litigation where success rates are very high. In particular, medical malpractice litigation, where as many as 70% of claims are not successful, is supported through a contingency fee system. Whilst this suggests that the introduction of contingency fees might not lead to a collapse in access to justice, there are limits to the extent to which comparisons with the US can be drawn. In particular, the higher levels of damages awarded at the upper range of cases in the US is crucial, not only because it is typically some of those cases which bring the system into disrepute but also because it is those cases which cross-subsidise the broader mass of cases in the system.

23. For that reason it is difficult to predict the impact of contingency fees on access to justice were they to be introduced in England and Wales. It may be possible to address this through further research.
24. There are other access to justice concerns which require discussion. Personal injury work is effectively supported through a contingency fee system because it gives rise to a regular supply of larger cases. Other areas of litigation where larger cases may be less likely to occur, or where the costs of bringing a case are habitually disproportionate to the damages awarded or agreed, would be less likely to survive under a contingency fee system (defamation and privacy actions may be one such example). Similarly, a contingency fee systems does not support claims in which the remedy sought is predominantly non-financial (e.g. some housing disrepair cases). CFAs can operate to support such claims.

25. A second problem is the risk that contingency fees impose limits on the amount of work that can be done on a case before it becomes uneconomic. This can lead to good cases being dropped and undersettlements. Research from the US suggests that claimant lawyers mitigate this somewhat because a) they cross-subsidise between economic and uneconomic cases and b) because they need to protect their reputation. Equally, the imposition of fee caps increases the number of cases that are dropped and also reduces the level of damages that cases settle for.¹²

26. This is an inherent problem with contingency fees. Cross-subsidy and reputation protection may mitigate it. Were contingency fees to be introduced, consideration might be given to strengthening the need to

protect reputation by, for example, requiring claimant lawyers to publish success rates and levels of average damages for different types of case. The feasibility and cost of this would need careful consideration.

The Americanisation Problem

27. Any proposal that contingency fees be introduced more broadly into England and Wales is likely to be greeted with the charge that it will, as a result, Americanise our system. This is, in effect, a suggestion that contingency fees would give rise to an avalanche of claims; that it would give rise to a greater number of frivolous or fraudulent claims; and that contingency fees would lead to an inexorable ratcheting up of damages to American levels. It is worth considering each of these in turn.

28. The popular view is that the United States is litigation crazy; a land awash with claims. Serious research presents a quite different picture:

“In a massive national survey of claiming behaviour, the Institute for Civil Justice estimated that claims were put forward in only about ten percent of all accidental injuries. Claims were made in forty-four percent of motor vehicle injuries, seven percent of work injuries, and three percent of other injuries. Thus, "claims associated with motor vehicle accidents accounted for almost two-thirds of the total." The Harvard study of medical malpractice in New York similarly estimated that "eight times as many patients suffered an injury from negligence as filed a malpractice claim in New York State. About sixteen times as
many patients suffered an injury from negligence as received compensation from the tort liability system”.13

29. Whether this level of claiming is higher than or lower than in England and Wales is moot. Hensler et al conducted the “massive national survey” referred to above and compared levels of claiming with Harris et al’s study in England and Wales.14 This is the most careful and robust comparison of comparative levels of claiming between the two jurisdictions of which we are aware. It found that in motor vehicle and non-work, non-motor vehicle injury cases, Americans were significantly more likely to consider claiming; but were not significantly more likely to seek legal assistance.15

30. Nor does the evidence support the view that contingency fees give rise to significantly more frivolous or fraudulent claims, indeed the evidence is that contingency fees improve the quality of claims brought.16 Nor are we aware of evidence that contingency fees drive increases in damages payments. There is a plausible argument that contingency fees will provide incentives on claimant lawyers to increase damages, particularly on bigger cases, but most of the evidence points to contingency fees


15 Hensler et al cited note . The other area of claim that they were able to look at could not provide valid comparisons: accidents at work are dealt with by worker compensation schemes in the United States so resort to claims and litigation was necessarily higher in England and Wales which does not have such schemes.

reducing amounts on settlement relative to hourly-rate payment.\textsuperscript{17}

\textbf{Lack of an incentive to settle problem}

It is sometimes suggested that contingency fees pose a threat to one of the successes of the Woolf reforms Part 36 offers. This problem may be overstated: conventional economic logic suggests that there are powerful incentives on lawyers to settle: it removes their risk; ensures cashflow and, where the work needed to proceed further with the case exceeds the likely increase in settlement, it maximises proportionality. In any event, there is evidence that ‘offers to settle’, analogous to Part 36 offers, can improve the operation of contingency fees and render the system of civil justice more efficient.\textsuperscript{18}

\textbf{What would an alternative look like?}

31. A key issue for contingency fee design is the cost recovery rules that go with it. These are discussed separately below in relation to ATE. Here this report concentrates on the key issues that would need to be faced should a contingency fee system be implemented.

\begin{footnotesize}

\textsuperscript{18} Yoon and Baker cited in note 5.
\end{footnotesize}
What level of uplift should be permitted?

32. There are three approaches to regulating fee uplifts: market forces; prescribed percentages or caps; and ex post facto control.

33. Permitting the market to find its level is only likely to work effectively where the claimant bears the cost of the uplift out of the compensation. In the US, there is evidence that a percentage fee of 33% is most common, but also subject to some variation downwards and upwards (generally not beyond 50%).

34. There is, however, very little evidence of competition between claimant lawyers on the basis of the percentage fee, so it would be misleading to suggest there was a market rate. It is understood that this may be more likely in class action cases, where firms are more likely to compete to get good cases.

35. The second approach could be to prescribe maximum percentage success fees. Competition could drive success fees down for certain types of case, but maxima would prevent contingency fees becoming too high. In the US, this approach is generally taken to limit the size of success fees chargeable on larger damages awards, to reduce the risk of lawyers claiming rewards from contingency fees that are disproportionate to their effort.

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19 See, in particular, Kritzer cited in note 4
36. The third approach is some ex post facto control on success fees, either through application to a judge on the basis that a success fee is unreasonable, and/or by way of a cross-check on costs through a lodestar (hours times hourly rate) calculation.

37. Conceptually the decision to impose maxima is a simple trade-off between the reduction of unreasonably high contingency fees and the extra access to justice higher fees would promote. There is evidence that, caps on success fees for higher value cases reduce the number of cases that proceed.\(^20\) In effect, the level of success fee that is permitted is a way of regulating the proportionality of the entire system. Some maximum may need to be set, but great care needs to be taken in deciding what that maximum should be and whether a series of maxima tapering down as damages awards get larger is appropriate. A series of maxima tapering would reduce the ability for cross-subsidy through the system but might also reduce any tendency for contingency fees to be charged that would be disproportionate to the amount charged.

38. Ex post facto regulation of contingency fees by judges, or by reference to a lodestar calculations has the advantage of building some discretion in to the system. Were contingency fees to be recoverable, it would also build in the likelihood of challenge which has caused so much difficulty in relation to CFAs and some of the transaction costs associated with hourly rate billing that a move to Contingency Fees should help avoid.

\(^{20}\) Danzon and Lillard cited in note 12
Recoverable contingency fees?

39. Whilst the US system does not generally enable contingency fees to be passed on to losing opponents, there are exceptions and there is no reason in principle why they can not be.\(^{21}\) Similarly, we see no reason in principle why recoverable contingency fees cannot operate with the mixed costs recovery regime we outline below.

Simplicity and the consumer

40. A key benefit of contingency fees is their relative simplicity. They are likely to be more easily understood by clients than the complex CFA mechanism. If contingency fees were to be recovered from claimant damages, this might give rise to consumer protection issues. Two particular examples are: (i) whether the contingency fee is inclusive of VAT and, (ii) how deductions (for example by the Compensation Recovery Unit) impact on what is paid to the lawyer. The critical issue is whether the percentage fee calculated by reference to the amount gross or net of VAT and deductions. There are similar issues around charges for disbursements.

41. Such issues can have a dramatic impact on the level of fee paid by a client. Research in the US suggests that lawyers manage this issue so as to reduce their payments when, for example, subrogation threatens the lion’s share of the claimant’s compensation.\(^{22}\) This would mitigate some, 

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\(^{21}\) See, Mark Humphries (2005) *A paradigm shift* (Legal Week, 26 May 2005)

\(^{22}\) Kritzer cited in note 4
but probably not all, of the problems for consumers. Making contingency fees recoverable from unsuccessful defendants would further mitigate the problem.

42. There are other consumer issues around charging and handling Contingency Fees, such as how lawyers should deal with clients who refuse (reasonable) advice to settle.

43. Were contingency fees to be introduced, these detailed issues of consumer protection would need to be given careful thought. There is ongoing research work in this area in the field of employment tribunal claims, where the same problems may manifest themselves.\(^{23}\) It will be important to specify clearly how the contingency fee is to be calculated (regarding deductions); whether disbursements are included in the percentage fee; and how other consumer protection issues are dealt with. Clarity will be important if claimants pay the success fee from damages because consumers are not likely to understand these rules and shop around for the best deal. They risk being exploited as a result. Clarity will also be important if defendants pay the success fee, to prevent the risk of challenge.

\(^{23}\) Moorhead and Cumming (2008) forthcoming
Do we need to move to contingency fees now?

44. Whilst a move to contingency fees has merit, and the potential (along with changes to the costs rules which are discussed below) to tackle many of the instabilities in the current system; the impact on access to justice may be too unpredictable to recommend their immediate implementation.

45. Current challenges to the level of success fees and the greater risks of disproportionality with CFAs, are not sufficient to make the system unviable at this current time. The main risk of a catastrophic failure in the CFA system is failure of the ATE market. It is policy responses to this problem which are most pressing. They could take a number forms.

46. These could include:

- a return to the pre-Access to Justice Act position.
- abolition of the English costs rule;
- introduction of one-way costs shifting; and
- a mixed-system
Contingency Fees – Moorhead and Hurst

47. A simple approach is to return CFAs to their pre-Access to Justice Act 1999 footing: that is to cease to permit additional liabilities (ATE premiums and success fees) to be recoverable. ATE premiums would be payable by the party bringing the claim (or conceivably by their lawyer). **This should inject some healthy market discipline**, with ATE insurers having to compete for the business of consumers (or more likely claimant lawyers) by reducing their costs, and it would reduce many defendant challenges to CFAs.

48. The disadvantages of this approach are that it would reduce the amount of any money paid over to a claimant in the event that their claim is successful, often significantly; and it may also act as a powerful disincentive against the bringing of strong cases simply because the insurance costs for those cases were too high for the individual claimant (although claimant firms and loan arrangements might develop approaches to mitigate this impact).

**Abolition of the English Costs Rule**

49. This section considers the Abolition of the English Costs Rule (that the losing party pays the winners reasonable costs). ATE provides protection against the risk of paying an opponent’s costs. Abolition of the risk would remove the need for ATE, but leave each party bearing their own costs even where their case was vindicated. There are also some broader pros and cons connected with the rule.

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24 The system is in fact more correctly referred to as the English and Welsh system but this Report adopts “English” as a shorthand.
50. It is generally held that the English rule will encourage the pursuit of ‘strong’ claims, but also increase the level of costs likely to be incurred on such claims (which may itself dampen down inclinations to claim). For example, Hause predicts an ‘arms race’-style investment by claimants and defendants operating under the English rule keen to improve their chances of shifting legal costs. On balance, Snyder and Hughes empirical research finds that the English rule costs help to screen claims and encourage those that are stronger.

51. A key problem with the no costs shifting approach is that claimants must meet their own lawyers’ costs (out of damages if they win), thus diminishing the extent to which they are properly compensated and also potentially impacting on the extent to which lawyers would be willing to take smaller cases.

52. Conversely, there are some benefits: because clients, not opponents, pay the costs they might exert some pressure on their own lawyers to drive down costs and thus begin to tackle the disproportionality problem. Claimant lawyers, for example, might be expected to behave as lawyers in the States, protecting their reputation with clients by not deducting too


heavily from damages. The Law Society voluntary cap\textsuperscript{28} was broadly
effective in discouraging solicitors from excessive deductions (although
this did not apply to non-solicitor claims handling companies).

53. The position here is often contrasted with the United States, although in
fact most cases have some recoverable costs (not dissimilar to our
disbursements) and some have fully recoverable costs more akin to the
English system. There is some evidence from the US that a mixed system
whereby an initial position of non-recoverability is combined with
recoverability through Part 36-type offers is more efficient than the ‘no
costs’ rule.\textsuperscript{29}

54. Removal of cost shifting may weaken disincentives against bringing weak
claims for uninsured claimants (because those bringing weak claims would
not be liable for their opponents’ costs, there is less risk to the client in
‘having a go’).

55. Similarly, claimant representatives would not be under any discipline from
ATE insurers (who sometimes demand high success rates for firms
wishing to be on their panels of those who can insure clients for standard
CFAs).

56. That is not to say there is no disincentive to the bringing those claims. Any
lawyer or claims handler bringing a claim has to invest their time in it. The
greater that investment, the less likely a weak claim would be brought.

\textsuperscript{28} 25\% of damages when success fees were not recoverable.

\textsuperscript{29} Yoon and Baker cited in note 5
The existence of weak claims in the system then depends on the defendants’ response to them: if they defend weak cases, the claimants’ representatives are more likely to withdraw such cases or not bring them in the first place. However, without costs recovery, the defendants have weaker economic incentives to defend such cases as they do not get their costs of defence back.

**Introduce one way cost shifting**

57. Another approach would be to introduce one way costs shifting whereby successful claimants recover their costs if they are successful in a case but pay nothing if they lose. It is used in the United States in over 200 statutes as a way of ensuring litigation in key areas is brought by claimants (often in civil rights and environmental matters). This would protect the current position of claimants (i.e. they would still get 100% of their damages and they would not be discouraged from issuing cases because of the threat of paying defendants’ costs). Defendants’ transaction costs might be reduced (they would no longer have to pay recoverable insurance premiums), although this might be offset by the impact of an increase in weaker claims.

58. It would be possible to tackle some of the perceived risks in one way cost shifting through regulation of claimant representatives.

59. A relatively light touch system should suffice which would require that claimant representatives who wished to take advantage of one way cost shifting lodge at the outset of a claim basic statistical information on the nature of the claim, the damages sought and further information on completion (e.g. outcome, compensation paid, costs shifted).
60. This might form the basis of public information which could in an anonymised and summary form inform consumer choice of suppliers as well as showing up patterns of settlement/losses which were capable of being monitored to see if the system generally, or even particular providers, was operating well.

**Introduce a mixed system**

61. Another approach is based on a mixture of the US and English systems. Under this approach, the losing party does not ordinarily pay the winning parties costs *unless* they have failed to beat a formal offer to settle (a Part 36 offer), or they have behaved unreasonably. This system combines some of the advantages of the above schemes with a degree of cost recovery between the parties which provides both parties with an incentive to settle where their opponent makes reasonable offers.

62. There is some risk to both sides. Claimants’ costs incurred before their representative makes a first offer would not be recoverable. Defendants face similar problems on weak claims as they do under the no costs rule and one way fee shifting, but with the capacity to mitigate their risk by making a low offer. If they decide to defend the case, they are in a similar position to the claimant solicitor: both parties have to invest in their decision to proceed with the case.
63. There is evidence from the US that this is more efficient than the no costs rule: reducing costs without lowering damages but the evidence is limited to one study and is in the context of contingency fees.\textsuperscript{30} Consideration needs to be given to the likely workings of an English and Welsh system.

64. A number of issues of detail and principle need to be resolved. For instance, would costs recoverable by defendants as a result of Part 36 offers need to be limited to the damages a claimant recovered; otherwise, wherever recoverable costs were likely to exceed an offer made by the defendant, the claimant would face incentives not to litigate similar to those under the English rule without ATE.

65. There is a question whether this needs to be true also of the costs to be recovered by claimants from unsuccessful defendants. There are two principal reasons for thinking not: one is that were this to be the case, \textit{claimants would be less likely to pursue valid cases} which were expensive relative to the damages in issue; the second is that defendants can protect themselves in any event by making an early Part 36 offer.

66. A counter to that argument might be that they would need to do \textbf{considerable investigation before making such an offer}. This, in fact, is likely to put them in a similar position to the claimant who would be obliged to put significant effort into investigating such a claim before making it.

\textsuperscript{30} Yoon and Baker cite in note 5.
67. There is a third, pragmatic reason: experience in the United States has shown that where defendants are able to recover costs against claimants, their ability to do so is often limited because of the difficulties of enforcing against, inter alia, impecunious claimants. If this experience were replicated here, the ability to recover costs beyond the compensation paid may be of marginal benefit to defendants.

68. Even with a limit on recoverability, the approach would build a degree of proportionality into the system.

69. On balance, were contingency fees to be introduced, replacing the current costs rule with a mixed system along the lines outlined above appears to be the optimum option.
Conclusions

70. So long as the present costs system in England and Wales continues to operate there is no pressing need to introduce any other type of costs system. The problems inherent in the present system are such, however, that it has to be accepted that the system may break down and policy needs to be developed to respond to that eventuality should it occur.

71. Fears that damages-based contingency fees would lead to an Americanisation of our civil justice system are almost certainly overstated. Any excesses in the American system appear to be driven by levels of damages and jury awards in particular rather than contingency fees.

72. Whilst it is possible for contingency fees to operate with fee shifting, our working assumption is that if CFAs collapse it will be because of failure of the ATE market. In that event, it is likely that the basic costs rules would have to be adapted, with loser pays perhaps being abolished or a move towards one-way costs-shifting. Even under abolition, there is the potential for fee-shifting to be introduced in partial form through the offers to settle process which may improve the effectiveness and efficiency of the claims process.

31 Alaska retains contingent fees whilst following general two way fee shifting, as do some Canadian Provinces. The mostly one way pro-plaintiff shifting provisions, common in the United States, can readily co-exist with contingent fees. See Award of attorney’s fees in Alaska: An analysis of Rule 82, 4 UCLA – Alaska L.Rev.129, 162-63 (1974); Cooper and Castner, Access to justice in Canada: The economic barriers and some promising solutions, (1) Access to justice 247, 259 (1978).
73. If fee shifting is done away with and contingency fees are permitted, the evidence suggests that, properly regulated, the new regime would operate satisfactorily and without the satellite litigation which bedevils the current system in this jurisdiction. Contingency fees would also be likely to introduce greater proportionality in the system.

74. It has to be accepted however that such a change might have a significant effect on which cases are brought (particularly low value cases) and thus access to justice could be adversely affected. Similarly cases which hinge on non-monetary remedies or where monetary remedies are low relative to legal costs would not be well-served by a damages-based contingency fee system. A partial solution to this dilemma would be the increase in the level of the small claims jurisdiction so that such cases could be litigated informally without the need for lawyers or with more packaged, limited cost support (again perhaps through contingency fees).

75. Were contingency fees to be introduced, consideration would also need to be given to consumer protection measures around the setting and charging of such fees (including disbursements; VAT and recoupment deductions); and settlement clauses. Broader regulation of fees in high value cases might also be considered, but it is important to bear in mind that restricting the levels of fee has a significant detrimental effect on access to justice.
Annex A

Glossary

**ATE**  After the Event Insurance. Insurance cover which protects litigants against the risk of having to pay the other side’s costs, and disbursements sometimes with self insured premiums.

**BTE**  Before the Event Insurance. Also known as Legal Expenses Insurance. Insurance that is purchased as an add-on mainly to car and house insurance policies. BTE provides the insured with limited cover for legal costs for advice and a range of disputes.

**Part 36 offers**  are formal offers to settle made by either party to a dispute. If the offer is declined by the recipient of that offer, and they subsequently fail to do better than that offer at trial or in any subsequent settlement, they pay all their opponents reasonable legal costs occurring after the Part 36 offer is declined (or has expired).

**Success fee**  The uplift on a fee paid on a CFA, being a percentage of the normal costs a lawyer would have charged on that case. Under a CFA the lawyer would get their normal fee (an hourly rate x the number of hours worked) + a percentage of that fee (the success fee) and would recover both those elements of the fee from their unsuccessful opponent.
ANNEX B

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