Report of the Working Party on Damages Based Agreements (Contingency Fees)

1. The terms of reference of the Working Party (WP) were set out by Lord Justice Jackson on behalf of the Civil Justice Council in a note **(annex 1)** dated 1st March 2012 during the passage of the Legal Aid, Sentencing and Punishment of Offenders Bill. The WP has held four meetings (17th April, 30th May, 20th June and 18th July) and provided an interim report to the CJC Executive Committee on 5th July.

2. In this document the term "DBAs" refers to damages based (contingency fee) agreements which are lawful under s.45 Legal Aid, Sentencing and Punishment of Offenders Act (LASPOA) 2012, amending s.58AA Courts and Legal Services Act 1990 (CALSA), previously amended by s. 154 Coroners and Justice Act 2009 (regulating DBAs in employment matters).

3. The use of DBAs in employment and other tribunal matters has always been lawful whether or not proceedings were initiated. Section 45 LASPOA extends s.58AA CALSA beyond the narrow scope of employment DBAs to **all** DBAs by removing from s.58AA all references to employment matters. Section 45 (9) LASPOA also makes it clear that proceedings in relation to DBAs *"includes any sort of proceedings for resolving disputes (and not just proceedings in court) whether commenced or contemplated".* The WP has therefore produced this report on the basis that the **recommendations** apply to all DBAs in all proceedings for resolving disputes whether issued or not.

4. The Damages Based Regulations 2010 were introduced to regulate the use of DBAs in employment cases only. However, because the new s.58AA CALSA covers **all** DBAs the WP **recommends (1)** that there should be only **one** corresponding set of regulations for all cases where the funding mechanism is by way of a DBA (but not by a CFA which is covered by separate regulations), whatever the nature of the claim and whether proceedings are issued or not.

5. In addition to its terms of reference the WP was requested by the Ministry of Justice (MOJ) to provide a definition of a DBA. The WP **recommends (2)** that the statutory definition of a DBA in s.58AA (3) (a) CALSA relating to DBAs in employment tribunals should apply to **all** DBAs.

6. The WP was also asked to assist with a definition of "personal injury" because special considerations apply when a DBA is used in a personal injury claim. The WP simply **recommends (3)** that the current general definition of personal injury in CPR 2.3, recently applied to the Qualified One Way Costs Shifting (QOCS) regime, should also be adopted in relation to DBAs. (This means that a professional negligence claim arising from a personal injury claim is **not** a personal injury claim).

7. In only four meetings over four months the WP has been required to debate the many complex issues that appear in this report and in the annexed papers which analyse the arguments for and against in more detail. In several areas there have been differences of opinion and the view on the best solution has not always been unanimous.

8. The terms of reference do not direct the WP to any particular model of DBA. However the WP has used as its starting point the (so called) " Ontario " model for the following reasons :

    - In Chapter 11 of his Final Report Lord Justice Jackson refers (paragraph 4.11) to the "satisfactory Canadian experience", and in his recommendation in favour of the introduction of contingency fees (paragraph 5.1) he says: *"Both solicitors and counsel should be permitted to enter into contingency fee agreements with their clients. However, costs should be recoverable against opposing parties on the conventional basis and not by reference to the contingency fee",* which is the basis of the Ontario model.

    - In paragraph 237 of its consultation paper (November 2010) the MOJ says: *"The reform of CFAs proposed by Sir Rupert in effect means that the success fee would be payable to claimants in successful cases. For DBAs he proposes costs shifting on the conventional basis, that is to say that fees chargeable under a standard hourly basis could be recovered from the defendant. Where the fee agreed under a DBA exceeds what would be chargeable under a standard hourly basis claimants would be paying that difference from their damages",* which is the basis of the Ontario model.

    - In conclusion number 13 of the Lord Chancellor's Response to consultation (March 2011) the Government says : *"Successful claimants will recover their base costs (the lawyer's hourly rate fee and disbursements) from defendants as for claims whether funded under a CFA or otherwise but in the case of a DBA the costs recovered from the losing side would be set off against the DBA fee, reducing the amount payable by the claimant to any shortfall between the costs recovered and the DBA fee",* which is the basis of the Ontario model.

- At a meeting of the CJC Executive Committee on 5th July Robert Wright (MOJ) confirmed that the Government intention is to introduce DBAs on the basis of the Ontario model.

- The words "specified financial benefit "in section 58AA (3) (a) (I) CALSA are not inconsistent with the Ontario model. **(annex 2)**

9. For the avoidance of doubt the Ontario model operates on the basis that :

   - Costs shifting applies;

   - Base costs recovered from a losing opponent belong to the client; and

   - By a contingency fee agreement retainer that complies with the indemnity principle the base costs are retained by the lawyer and are deducted from damages (set off against) the contingency fee to make up the difference (shortfall) between the base costs and the contingency fee.

   However, although comparison with the use of DBAs in Ontario has been of considerable assistance in its deliberations, the WP **recommends (4)** that the DBA that is approved for use and regulated in England and Wales is **not** referred to in the Rules and Regulations (see **annex 6)** as the "Ontario" model.

10. The WP has debated at considerable length the particularly difficult issues that arise in relation to the proposed **level** of the percentage cap on the contingency fee in personal injury cases (see later). In **annex 3** the WP reviews two optional contingency fee models in personal injury cases, one still described as the "Ontario model", the other described as the "Success fee model", each with worked examples. The essence of the Ontario model is that the lawyer is not entitled to the full percentage contingency fee. It is a contingent contingency fee which governs total remuneration for all lawyers involved after taking into account all base costs recovered. This could result in the client retaining 100% of damages (see worked examples in **annex 3).** The alternative to the Ontario model would be to allow the lawyer to retain a contingency fee in all cases in addition to the costs recovered so that the contingency fee functions very much like a success fee in a CFA. Some members of the WP saw advantages in this model if properly regulated and it is discussed in some detail in **annex 3.** There is a concern that where the ratio between costs and damages means that there is little or no contingency fee available to reward the lawyers for risk (even allowing for recovery of base costs between the parties costs) the case will not be taken because it will be uneconomic. The argument then follows that the contingency fee should therefore be allowed as a success fee **in addition to base costs**. The uneconomic argument has some resonance with the related issue of the **scope** of the cap in personal injury cases (see later).

On balance, the WP prefers and **recommends (5)** the Ontario model, which is the basis of all its further recommendations below, but adds the important caution that care will need to be taken in determining precisely what elements of unrecovered costs (solicitor's fees, counsel's fees, VAT, ATE premium and disbursements) may be taken from the contingency fee after prior deduction of recovered base costs and disbursements.

11. The response of the WP to the eight terms of reference set out by Lord Justice Jackson on behalf of the CJC is as follows :

i. **To consider the conflicting interests which are in play when proceedings are brought or defended on a DBA, in particular the interests of the clients, the lawyers, those to whom the lawyers instruct and opposing parties.**

- Members of the WP who are representatives of the Solicitors Regulation Authority (SRA) and the Bar Standards Board (BSB) have advised that their respective regulations already deal with professional and ethical issues of conflict generally and in respect of the now well established "no-win, no-fee" method of funding civil cases. However, the WP **recommends (6)** that the SRA and BSB review their current guidance to ensure that the use of new DBAs is adequately covered alongside the existing guidance in relation to CFAs.
- The position of opposing parties is dealt with in paragraph vii below

ii. **To make recommendations as to what, if any, regulations ought to be made in the public interest under s.58 AA (3) and (4) for example limiting the percentage that the lawyers should be entitled to recover or requiring court approval in certain circumstances.**

The WP has deliberated at length on the complex issues that arise under this term of reference and has taken into account the following documents that have contributed to the debate **(annex 4):**

- Should a cap be imposed on the contingency fee to be deducted from damages? Do different considerations apply to commercial cases? (Spencer/Smith)
- What cap, if any, should be imposed on the contingency fee to be deducted from damages (draft options) (Spencer)
- Options for contingency fee caps and controls (Stutt)
- Cap on success fees (PIBA)
- Why ten per cent? (Jackson)
- Client protection and the ability to challenge costs charged under a damages based agreement (Bacon)
- Legal aid reform : application of the supplementary legal aid scheme(SLAS) (MOJ)
- DBAs in employment cases (Moorhead)

- Something for nothing : employment tribunal claimants' perspectives on legal funding (Moorhead)
- Caps on Success Fees in CFA cases and contingency fees in DBA cases (Pickering)

From April 1st 2013, the funding mechanism of a DBA may be used in three types of civil dispute: employment, personal injury and commercial. The latter type of case needs to be sub-divided into (i) commercial and (ii) consumer and (iii) micro –enterprise as defined in the FSA Handbook (DISP 2.7.3 and 2.7.10) to which different considerations apply when considering whether to limit the percentage ("the cap") on the costs that can be taken out of the contingency fee.

In employment cases, section 5 of the Damages Based Regulations 2010 already limits the cap to 35% including VAT. The WP can see no reason to interfere with the existing (and as recent as 2010) statutory control on the level of contingency fee in employment cases funded by a DBA. The WP therefore **recommends (7)** that in employment cases the cap should remain at **35%.**

In personal injury cases the position is quite different. In his final report (Chapter 12 on contingency fees, paragraph 4.11 on personal injuries litigation) Lord Justice Jackson said: *""However, the cap on deductions from damages should be the same for CFAs and contingency fee agreements. I therefore recommend that no contingency fee deducted from damages should exceed 25% of the claimant's damages, excluding damages referable to future costs or losses"*. Subsequently the MOJ has made clear in its consultation paper (November 2010) and Report (March 2011) that it intends to adopt Lord Justice Jackson's recommendation that the level of the contingency fee in personal injury cases should be capped at a maximum of 25% of damages and that the scope of the cap should be limited to past losses and general damages (pain, suffering and loss of amenity). The WP has considered the potential consequences of both of these proposals.

Some members of the WP are cautious about agreeing that the cap should be 25% without certainty as to what should be included in / excluded from the cap for reasons expressed above and in **annex 3.** However, on the basis that the contingency fee excludes unrecovered disbursements and any ATE premium the WP **recommends (8)** that the cap on the contingency fee in personal injury cases should be **25%.**

In balancing the arguments on the **scope** of the cap the WP has taken into account:

- Lord Justice Jackson's tenth implementation lecture ("Why ten per cent?") on 20th February 2012 when he said (footnote 13) : *"The Personal Injuries Bar Association (PIBA) and the Bar Council have recently sent to me forceful submissions that the 25% cap should apply to ALL damages, as it did before April 2000. I can see the sense of allowing that dispensation in appropriate cases provided that the success fee is only payable by the client as it was pre-April 2000. The reason why I proposed ring*

fencing damages in respect of future loss was out of deference to the vociferous submissions of PIBA,APIL and others in 2009".

- Arguments that there is a danger of denied access to justice in cases where the effect of the limited cap on the damages/costs equation makes it uneconomic for the lawyer to accept instructions (see again **annex 3**)
- The difficulty of defining the "appropriate cases" in which the limited cap should not apply, without burdening the Courts with having to decide probably numerous and complex applications for dispensation.
- The problem of global offers of settlement which by definition make it impossible for the claimant's lawyers to separate out the different heads of damage to which the cap should apply, leading to the risk of solicitor/client disputes requiring Court resolution and /or complaints to the professional regulatory organisations.
- The fear that an unlimited cap would lead to lawyers in large damage cases receiving "windfall" costs, a risk that was also present when CFAs were first introduced in 1995 using the Law Society's 25% voluntary cap that did not give rise to client dissatisfaction or complaint.
- The appreciation that in a large damages case (or indeed in any case whatever size or nature) the percentage contingency fee may be agreed at less than 25% particularly as market forces under the new costs regime post April 2013 may lead to increased competition between lawyers as to the percentage charged.
- The fear of excessive inroads into damages required for future care if the contingency fee is deducted from future care costs and future losses. It appears from Lord Justice Jackson's tenth lecture (see above) that various legal and other organisations, no doubt all concerned about the consumer interests of seriously injured claimants, made representations about this aspect. However, as above in relation to the risk of windfall costs, under the initial CFA regime between 1995 and 2000 there is no history of client dissatisfaction or complaint.(75% of something is better than 100% of nothing.)
- Whether, in addition to the % cap, there should be a further cap on the total remuneration the lawyers can receive e.g. no more than double their costs. However, this argument must be balanced against the basic rationale of the no win – no fee model that the winning cases have to pay for the losing cases which is a particularly critical issue for barristers willing to take the risk of losing and not being paid.
- The relationship between DBAs (and CFAs) and QOCS, particularly where a part 36 offer is not beaten by the claimant, will be made even more difficult when the damages available for contingency fee costs have to be calculated taking into account a limited cap.
- The common purpose that (as applied in type 1 CFAs in 1995) all personal injury claimants whose cases are funded by a DBA or a CFA or under SLAS (even though

the levy does not go to the lawyers) should be guaranteed a minimum of 75% of their damages recovered.

- The arguments, options and examples in **annex 3**
- All the papers listed in **annex 4**

After very careful consideration of all the above arguments the WP **recommends (9)** that **(I)** in personal injury cases conducted on a DBA the contingency fee (comprising solicitor's fees and counsel's fees plus VAT) but excluding disbursements and ATE premium should be capped at a maximum of 25% and **(ii)** the damages from which the contingency fees can be taken should **not** be limited and **(iii)** the base costs recovered between the parties should be deducted from the contingency fee.

As stated above, **commercial cases** (non-personal injury and non- employment) divide into three categories: (i) commercial (ii) consumer and (iii) micro enterprise as defined in the FSA Handbook (fewer than 10 employees and a turnover or balance sheet that is less that 2 million Euros).

Category (i) is likely to involve sophisticated purchasers of legal services entering into contractual arrangements where freedom of bargaining should not be inhibited. The WP considered this carefully, but on balance **recommends (10)** that in this category of commercial case there should **not** be a cap on the contingency fee.

Categories (ii) and (iii) are open to argument that some level of protection is required at a level that is less than a personal injury claim (25%) and less than an employment claim (35%). If a protective cap is to be applied to categories (ii) and (iii) the WP would **recommend (10)** that it should be 50%. However, the WP was divided on the issue of whether a cap should be applicable for sub-categories (ii) and (iii) of commercial/consumer claimant.

The WP was also requested to consider whether in certain circumstances the percentage contingency fee recoverable under a DBA should be approved by the Court. It is straightforward to **recommend (11)** that in the usual way, where the DBA relates to a claim on behalf of a child or patient the Court should approve the costs at the same time as approving the settlement.

The WP has also considered the special factors that apply to multi party/group/collective actions and having looked at the case law on DBAs in group/collective actions in Ontario and Australia **(annex 5)** concludes that special controls are necessary in this area of complex litigation where large numbers of claimants are involved and funding options very limited. Although it is normal for solicitors representing numerous clients in a group action to apply to the Court for a Group Litigation Order there is no compulsion to do so. The definition of a group action is often regarded as a claim involving more than ten claimants with the same generic cause of action. The WP therefore **recommends (12)** that when

lawyers who wish to use a DBA to fund a multi - party/group/collective action make an application to the Court for a Group Litigation Order (GLO) they should simultaneously apply to the Court for approval of the level of the contingency fee within the regulated cap on the % deduction from damages. If a GLO is not sought the level of the contingency fee will be open to challenge by the clients at the end of the case.

In the context of group /collective actions and although it is not strictly within the WP's terms of reference, it is relevant to draw attention to the Government's proposal (currently under consultation by BIS) to introduce the "opt out" model for collective actions in competition (cartel) cases but to simultaneously propose a ban on the use of contingency fees in such actions. The WP takes this opportunity to say that it believes this policy is misguided because the collective action is precisely the type of civil claim that will benefit from the introduction of DBAs to ensure access to justice.

Having decided on its recommendations as to the level and scope of cap in different types of DBA case, the WP is also asked in this term of reference to recommend "what if any regulations should be made in the public interest under s 58AA (3) and (4)…." to implement its recommendations. Other aspects of the control and contents of a DBA by way of regulation are raised in terms of reference (iii) to (viii) below.

In all of these areas it has not been the task of the WP to draft (a) the contents of the Statutory Instrument to implement the commencement of lawful DBAs or (b) amendments to the Civil Procedure Rules or (c) amendments to the rules / guidance of the regulators of the legal professional organisations (under the oversight of the Legal Services Board). Instead, and consistent with paragraph 4 above, the WP has reviewed in **annex 6** the current provisions of the DBA Regulations 2010 together with s.58AA CALSA as amended and s.45 LASPO. **Annex 6** also contains the WP's suggested contents of a DBA, including where the DBA is entered into by a claims management company providing claims management services (s.58AA(3)(a)).

The WP has sought to make proposals that will studiously avoid the risk of repeating the so called costs wars that followed the type 2 CFA regulatory regime introduced in 2000 and the risk of a regulatory imbalance between the requirements of a DBA and a CFA which is now a "light touch" regime. The WP **recommends (13)** that those who draft the rules and regulations consider the suggested draft in **Annex 6** and pay attention to the desirability of consistency of approach in the regulation of DBAs and CFAs, allowing for the basic differences in the two models. The WP adds some cautionary words about the cap. Any % cap on the level of the contingency fee will need to be prescribed by regulations and in order to implement the "Ontario model" as described in paragraphs 8 and 9 above the cap will need to be defined in more detail than for employment matters in the current DBA Regulations 2010.

(iii) To make recommendations as to what, if any, rules of court in relation to assessment of costs ought to be made in the public interest under s.58AA (6)

Consistency of approach demands that the same regime should apply to the assessment of costs in a DBA as the current regime that applies to CFAS. The WP therefore **recommends (14)** that CPR 44 is amended where necessary to include reference to DBAs.

(iv) To make recommendations as to what matters should be provided for in any DBA

In the same way that the WP has not drafted the wording of a statutory instrument or the detail of rules and regulations it has not drafted a model DBA. Any attempt to do so would have been an impossible task given the wide variety of cases that may be funded by a DBA. However **annex 6** proposes the essential provisions that should be included in a lawful DBA. Once again the WP is alert to the danger of encouraging satellite litigation and avoiding further Costs Wars. It is therefore not attracted to the detailed list of "dos and don'ts" in a DBA under the Ontario Solicitors Act Regulations 195/2004. In the 15 years since CFAs have been lawful the legal profession's various specialist litigation associations have produced their own varieties of model CFA. The WP therefore **recommends (15)** that the same steps should be taken by the specialist associations and professional bodies in relation to model DBAs.

(v) To consider whether, and if so in what circumstances, a lawyer acting under a DBA should be liable for adverse costs.

Under the costs shifting regime that operates in our jurisdiction the risk of an unsuccessful party (or their lawyers) having to pay adverse costs if the case is lost is a particularly important issue where litigation is conducted under the no win - no fee model. Since 1995 when CFAs were first introduced the risk of an adverse costs order against an unsuccessful claimant has been covered by the advent of the now mature after the event (ATE) insurance market. However, the introduction of QOCS will essentially remove the risk of adverse costs in a personal injury case whether conducted on a CFA or a DBA. The future of the ATE market in personal injury cases is a matter of speculation that is outside the remit of the WP.

In non- personal injury cases (in reality commercial cases excluding employment) where QOCS does not apply, scope may remain for the ATE market to offer cover to claimants (or sometimes defendants) against the risks of an adverse costs order if they lose their case whether on a CFA or a DBA **(annex 7).** However, there may also be a risk of an adverse costs order against the claimant's lawyers if allegations are made that they have conducted themselves in a manner that breaches the rules against maintenance and/or 'champertous' behaviour. Where lawyers are instructed to act on a CFA the Court of Appeal decision in *Hodgson v Imperial Tobacco* provides that they are immune from an adverse costs order. It would be consistent and sensible to extend the same immunity to lawyers acting on a DBA.

The WP therefore **recommends (16)** that some appropriate mechanism (possibly the CPR) is adopted to extend "Hodgson immunity", or such protection as the Court of Appeal has held exists, from adverse costs to lawyers acting on a DBA.

The issues that arise in this area of adverse costs are complex and have required much consideration by the WP **(annex 8)** including the question whether a third party litigation funder (TPLF who provides commercial funding of costs in return for a share of damages) in a DBA case should be liable for limited adverse costs under the same principle as the Court of Appeal in the *Arkin* case which involved a CFA. Again, consistency of approach as between CFAs and DBAS in the treatment of the adverse costs immunity of TPLFs is desirable.

The WP therefore **recommends (17)** that some appropriate mechanism (possibly the CPR) is adopted to make it clear that the *Arkin* principle also applies to a TPLF who provides commercial finance in a DBA case. There has been some speculation about the effect of Alternative Business Structures (ABSs) on the liability of TPLFs for adverse costs where the TPLF has an ownership share in the ABS. However, the WP does not feel that this is a matter that could at this stage be the subject of rules or regulation and is best left to the Courts to resolve if and when a question arises in a particular case.

There has also been some speculation about the situation where in a DBA case the lawyer agrees with the client to be liable (or partially liable) for adverse costs in return for a higher contingency fee. If such an agreement is made the resolution would be a matter of contract between the lawyer and the client against whom the adverse costs order is made. This is not an area where the WP feels that it is necessary to make a recommendation.

(vi) To consider whether it should be possible to enter partial DBAs, analogous to the "no win, low fee" CFAs.

There is no reason why the situation in relation to so called blended fee arrangements which are sometimes used in CFA cases (mainly in commercial cases) should be any different for DBAS. In either scenario (CFA or DBA) the no win-no fee element would have to comply with the statutory framework, the CPR and the professional regulations, for example in relation to the cap on the contingency fee element. The WP does not feel it necessary to make any specific recommendation on this point.

(vii) To consider whether there should be an obligation to notify opposing parties that the lawyers have entered into a DBA.

In CFA cases the abolition of recoverability of success fees and ATE premiums together with the introduction of QOCS is likely to remove the need for the claimant's lawyers to give notice to the other side that they are acting on a CFA. Once again for reasons of consistency between CFAs and DBAs the same approach should be adopted for DBAs. The WP therefore

recommends (18) that there should not be an obligation to notify the opposing party that lawyers have entered into a DBA and that appropriate amendments are made to the CPR.

(viii) To take account of the experience of DBAs (a) in employment tribunal cases in England and Wales and (b) in the Courts of Ontario, liaising as appropriate with both judges and practitioners in those jurisdictions.

As illustrated by the various annexes to this report (particularly **annex 9**) the WP has undertaken as much research as has been possible in the time available into the experience of practitioners and the judiciary where DBAs are used in other jurisdictions and in employment cases in this jurisdiction. The legislation in the UK and Canada that the WP has considered is listed in **annex 10.** A list of the WP's fifteen recommendations is included at **annex 11.**

The WP hopes that the recommendations in this report assist the smooth introduction of contingency fees as an important addition to the funding options for providing access to justice in civil cases and wishes to thank all those who have helped its deliberations and the CJC Secretariat for its support.

25th July 2012