THE LAW REFORM COMMISSION OF HONG KONG

CONDITIONAL FEES SUB-COMMITTEE

CONSULTATION PAPER

CONDITIONAL FEES

EXECUTIVE SUMMARY

(This Executive Summary is an outline of the Consultation Paper. Copies of the Consultation Paper can be obtained either from the Secretariat, Law Reform Commission, 20/F, Harcourt House, 39 Gloucester Road, Hong Kong, or on the internet at<http://www.hkreform.gov.hk>.)

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 members of the Sub-committee on Conditional Fees 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

What are conditional fees?

3. 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. This type of fee arrangement is usually allowed only in civil litigation cases, although the scope of application differs amongst jurisdictions.

Terminology

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

4. 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 consultation 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

5. 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

6. 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.

Chapter 1
The costs of litigation

Who pays for litigation?

7. *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 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.

8. *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.

9. *Tax deductions* – Businesses are major users of the court system, and that legal expenses incurred are generally tax deductible. Many people saw the tax deductions available to business litigants as inherently inequitable because they were not also available to individual litigants.

10. *Legal practitioners* – In jurisdictions which allow event-triggered fees, the litigation costs of unsuccessful cases are borne by the legal practitioners. 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. In Scotland, by contrast, it is estimated that only about 1% of all cases are charged on a

speculative basis. As for the United States, in the absence of legal aid, contingency fees are one of the principal sources of financing for litigation.

11. *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.

12. *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

Costs to follow the event - the costs indemnity rule

13. The unsuccessful litigant will usually be ordered to pay the legal costs of the successful party, in addition to paying his own legal costs. This rule is referred to as the "costs indemnity rule", and is also the basic costs allocation rule for civil proceedings in the United Kingdom, Canada, Japan and most European countries. 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.

Legal aid as a source of finance for civil litigation

The merits test

14. 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 will take into account all factors which would influence a private client considering taking proceedings. 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.

The means test

15. The means test evaluates whether an applicant's financial resources exceed the statutory limit allowed for the relevant legal aid scheme. Financial resources are taken as an applicant's monthly disposable income

multiplied by 12, plus his or her disposable capital. Monthly disposable income is the difference between gross monthly income and allowable deductions, which are rent, rates and statutory personal allowances for the living expenses of the applicant or his or her dependants.

16. 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.

Ordinary Legal Aid Scheme

17. To qualify for legal aid for civil proceedings under the Ordinary Legal Aid Scheme, the applicant's financial resources must not exceed $155,800. 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. 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.

Supplementary Legal Aid Scheme

18. 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 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. Supplementary legal aid is available for a range of cases 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.

Provisions against conditional or contingency fee arrangements in Hong Kong

19. In Hong Kong, a solicitor may not enter into a conditional or contingency fee arrangement to act in contentious business. The restriction stems from legislation, conduct rules, and common law.

20. The Legal Practitioners Ordinance (Cap 159) 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.*"

Chapter 2
Contingency fee arrangements in the USA

The percentage contingency fee

21. 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. 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.

22. Understandably, the contingency fee system has come under criticism and initiatives proposing a ceiling on contingency fees in tort actions have been launched. 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.

23. Some believe 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.

Chapter 3
Legislative changes in England concerning conditional fees

Maintenance and champerty

24. 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. "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.

25. 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.

Criminal Law Act 1967

26. In modern times, maintenance and champerty as crimes and torts fell into disuse and they were duly abolished in England in 1967. 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.*"

Courts and Legal Services Act 1990

27. Section 58(3) of the Courts and Legal Services Act 1990 legitimised conditional fee agreements, so that a conditional fee agreement "*shall not be unenforceable by reason only of its being a conditional fee agreement*". The Act empowered the Lord 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 and Conditional Fee Agreements Order 1995

28. 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.

- 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%.

After-the-event insurance

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

30. 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. 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.

Counsel's fees

31. 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. The "cab rank" rule does not apply to conditional fee agreements and counsel cannot be compelled to accept instructions on a conditional fee basis.

Evaluation of conditional fee agreements in 1997

32. 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 found that, within 15 months of their introduction, conditional fee agreements had become an established method of payment for personal injury litigation. Another source also found that the conditional fee arrangement was "*generally judged a success*".

Further reforms 1998 – 2000

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

Access to Justice Act 1999

34. 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. 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.

(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, subject to taxing down by the Court.

35. 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), [2002] 1 WLR 2000, 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.*
>
> *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.*
>
> *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. …"

36. 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."

37. 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.

The Conditional Fee Agreements Regulations 2000

38. 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.

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

39. 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.

40. 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.

Conditional Fee Agreements (Miscellaneous Amendments) Regulations 2003

41. 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.

Possible further legislative changes

DCA Consultation Paper June 2004

42. 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 …*".

(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.

(3) Defamation cases

The DCA referred to the decision of the Court of Appeal in *Adam Musa King v Telegraph Limited*, [2004] EWCA (Civ) 613 which concerns a defamation action brought under a conditional fee agreement without any ATE insurance cover.

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.

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. 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.

The use of conditional fee agreements in England

43. 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.

44. 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. As for commercial actions, conditional fee agreements are used only to a limited extent.

45. 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

46. 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:

- 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.

Chapter 4
Problems and litigation in England

Litigation on the recoverability of success fees and insurance premiums

Callery v Gray

47. The case of *Callery v Gray,* 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. 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.

48. 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 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.

The prematurity issue

49. 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 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.

50. 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.

Court of Appeal decision

51. 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.

The House of Lords decision

52. 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. But Lord Scott commented that 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."*

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.

53. 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."*

Reasonableness of the success fee

Court of Appeal decision

54. 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.

Two-stage success fee

55. 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.

House of Lords decision

56. 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.*" 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.

Reasonableness of the ATE premium

Court of Appeal decision

57. 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)*,* 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. …"*

House of Lords decision

58. Lords Bingham, Nicholls and Hope did not address the issue of the reasonableness of the ATE premium. 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. 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.

King v Telegraph Group Ltd

59. 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.

60. 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.

61. 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*".

62. 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]*

- *"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]*

Chapter 5
Event-triggered fees in other jurisdictions

Australian jurisdictions

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

63. A report published by the Australian Law Reform Commission ("the ALRC") found that it was common for lawyers to engage in conditional and speculative fee arrangements. The ALRC found that the lawyers in those cases carried much of the financial risk and provided considerable low cost assistance in financing litigation. The speculative and conditional fee arrangements had also assisted in promoting parties' access to the litigation process.

64. 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. Unlike the United States, contingency fees calculated as a percentage of the sum awarded by the court are not permitted in Australia. 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)

Canadian jurisdictions

65. Contingency fees are widely practised in each of the Canadian provinces and territories. 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. 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.

Ireland

66. 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

67. 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

68. 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.

Scotland

69. 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. If the case is lost they are paid nothing. 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 unsuccessful pursuer remains liable for the costs of his successful opponent.

Chapter 6
Arguments for and against conditional fees and related issues

Introduction

70. 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

71. The 1989 Green Paper identified three main arguments against event-triggered fees:

(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 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.

The 1989 Green Paper pointed out that 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. 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.

(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.

72. Arguments for the introduction of event-triggered fees set out in the 1989 Green Paper were:

(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.

(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.

Other issues to be considered

Counsel

73. 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. 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

74. 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. 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. Within three years, the scheme was in difficulties, primarily through adverse selection of cases by solicitors. 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.

Intermediaries

75. 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 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.

76. 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. 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

77. 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.

78. 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.

79. 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.

(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 Hong Kong situation

Access to the courts

80. Access to the courts is one of the fundamental rights constitutionally protected by the Basic Law. 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. As for civil trials and civil appeals in the High Court, the percentage of hearings involving unrepresented litigant(s) rose from about 37% in 2001 to 42% in 2004. As for civil trials in the District Court, the percentage during the years 2001 – 2004 remain at about 49%.

Additional arguments for and against event-triggered fees in Hong Kong

81. 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 insurance to cover legal costs. There is no certainty that insurers in Hong Kong would be willing or able to provide such cover.

82. 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.

Chapter 7
Proposals for reform

Should we allow conditional fees?

83. The Sub-committee has considered the arguments for and against the introduction of conditional fees, 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.

84. 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.

85. 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

86. The Sub-committee has made the following recommendation:

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

87. 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.

88. The change in the law 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. The Sub-committee believes it is inequitable, irrational and unfair to make insurance premiums and success fee recoverable from the losing party.

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

89. 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* discussed above, 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*, a success fee of 5% was thought to be appropriate for claims settled before the commencement of proceedings.

90. 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.

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

91. 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* 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.

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

92. 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.

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

93. The Sub-committee has made the following recommendation:

> **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

94. 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. 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.

95. 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.

- 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

96. 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, 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.

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

97. 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.

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

98. In a jurisdiction which adopts the costs indemnity rule 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.

99. 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. 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* 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.

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

100. 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. 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.

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

101. 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 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.

102. This idea is similar to the "Contingency Legal Aid Fund" ("CLAF") proposed by the English Bar. 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). The UK Government rejected this proposal on several occasions 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. 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.

- If deficiencies occurred, there would be a drain on public funds.

103. 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. 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.

104. 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.

105. 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”.

106. 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 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.

Conclusion

107. 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.