

THE LAW REFORM COMMISSION OF HONG KONG

REPORT

CONDITIONAL FEES

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July 2007

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CONTENTS

<i>Chapter</i>	<i>Page</i>
Preface	1
Terms of reference	1
The Sub-committee	1
The consultation exercise	2
Conditional fees are not contingency fees	3
Terminology	3
<i>Contingency fees</i>	3
<i>Conditional fees</i>	3
<i>Speculative fees</i>	4
<i>Outcome-related fees</i>	4
Layout of this report	4
Acknowledgement	4
1. The costs of litigation	6
Who pays for litigation?	6
Third party funding	8
Relevant costs rules in Hong Kong	9
<i>Costs to follow the event – the costs indemnity rule</i>	9
Bases of taxation in Hong Kong	11
<i>Costs on the party and party basis</i>	11
<i>Costs on the common fund basis</i>	11
<i>Costs on the indemnity basis</i>	11
<i>Costs as between a solicitor and his own client</i>	12
<i>Costs on the trustee basis</i>	12
Other costs aspects	13
<i>Counsel's fees</i>	13
<i>Costs of litigant in person</i>	13
Legal aid as a source of finance for civil litigation	14
<i>The merits test</i>	14

Chapter	Page
<i>The means test</i>	14
<i>Ordinary Legal Aid Scheme</i>	15
<i>Supplementary Legal Aid Scheme</i>	16
<i>Criminal Legal Aid</i>	17
Provisions against conditional or contingency fee arrangements in Hong Kong	18
 2. Contingency fee arrangements in the USA	 20
Introduction	20
The percentage contingency fee	21
Criticisms of contingency fees	22
<i>Frivolous litigation</i>	22
<i>Conflict of interest</i>	22
<i>Excessive fees</i>	23
Advantages of contingency fees	24
Other unique features of the American civil justice system	24
<i>Costs do not follow the event</i>	24
<i>Trial by jury</i>	25
<i>Punitive damages</i>	25
<i>Specialised plaintiff bar</i>	25
<i>Precedents not binding</i>	26
<i>Discovery</i>	26
<i>Absence of legal aid</i>	27
<i>Class actions</i>	27
<i>Non-specific pleadings</i>	27
New York State	28
Conclusion	28
 3. Legislative changes in England concerning conditional fees	 29
Introduction	29
Maintenance and champerty	29
Criminal Law Act 1967	30
Solicitors Act 1974	32
The Royal Commission on Legal Services 1979	32
Green Paper on Contingency Fees 1989	32
<i>Options set out in the 1989 Green Paper</i>	33
<i>Responses to the 1989 Green Paper</i>	33
Courts and Legal Services Act 1990	34
Conditional Fee Agreements Regulations 1995 and Conditional Fee Agreements Order 1995	34
After-the-event insurance	37
Counsel's fees	38
Evaluation of conditional fee agreements in 1997	38
Further reforms 1998 – 2000	40

Chapter	Page
<i>Consultation Paper on “Access to Justice with Conditional Fees” 1998</i>	40
<i>Conditional Fee Agreements Order 1998</i>	41
<i>Access to Justice Act 1999</i>	41
The Conditional Fee Agreements Regulations 2000	43
<i>General requirements</i>	43
<i>Conditional fee agreements with a success fee</i>	44
<i>Information which must be given to a client before making a conditional fee agreement</i>	44
Collective Conditional Fee Agreements Regulations 2000	45
The Civil Procedure (Amendment No 4) Rules 2003 – Fixed costs	46
Conditional Fee Agreements (Miscellaneous Amendments) Regulations 2003	48
DCA Consultation Paper June 2003	48
Conditional Fee Agreements Forum 2003	49
DCA Consultation Paper June 2004	49
Civil Justice Council’s Report August 2005	54
Repeal of the Conditional Fee Agreements Regulations	55
The use of conditional fee agreements in England	56
 4. Problems and litigation in England	 58
Introduction	58
Litigation on the recoverability of success fees and insurance premiums	58
<i>Callery v Gray</i>	58
<i>The jurisdiction issue</i>	59
<i>The prematurity issue</i>	59
<i>Court of Appeal decision</i>	60
<i>Government policy</i>	60
<i>Policy and practical considerations</i>	60
<i>The House of Lords decision</i>	62
<i>Reasonableness of the success fee</i>	64
<i>Court of Appeal decision</i>	64
<i>Two-stage success fee</i>	65
<i>The House of Lords decision</i>	65
<i>Reasonableness of the ATE premium</i>	67
<i>Court of Appeal decision</i>	67
<i>The House of Lords decision</i>	67
<i>Comments on Callery v Gray</i>	68
<i>Halloran v Delaney – from 20% success fee to 5%</i>	68
<i>Comments on Halloran v Delaney</i>	69
The effect of BTE insurance on the recoverability of ATE premiums	70
<i>Sarwar v Alam – 2001</i>	70
<i>Sarwar v Alam – 2003</i>	72
<i>Re Claims Direct Test Cases</i>	73
The position of outcome-related fee at common law and problems with the costs indemnity rule	74

Chapter	Page
<i>British Waterways Board v Norman</i>	74
<i>The indemnity rule</i>	75
<i>Public policy</i>	75
<i>Aratra Potato Co Ltd v Taylor Joynson Garrett</i>	77
<i>Thai Trading Co v Taylor</i>	77
<i>Bevan Ashford v Yeandle Ltd</i>	78
Post <i>Thai Trading Co</i> and <i>Bevan Ashford</i> decisions	79
Cases not following <i>Thai Trading Co</i>	79
<i>Hughes v Kingston-upon-Hull City Council</i>	79
<i>Awwad v Geraghty & Co</i>	80
<i>Significance of Awwad after 1 November 2005</i>	81
Claims intermediaries	81
<i>English v Clipson</i>	81
The scope of application of section 58 of the Court and Legal Services Act 1990	83
<i>R (Factortame Ltd) v Secretary of State for Transport, Local Government and the Regions (No 8)</i>	83
<i>Hollins v Russell</i>	84
Post <i>Hollins v Russell</i>	86
<i>Bowen v Bridgend County BC</i>	86
<i>Samonini v London General Transport Services Ltd</i>	87
<i>Garbutt v Edwards</i>	87
<i>Garrett v Halton BC and Myatt v National Coal Board</i>	88
<i>Other recent technical challenges</i>	88
Defamation cases	89
<i>King v Telegraph Group Ltd</i>	89
<i>Turcu v News Group Newspaper Ltd</i>	90
<i>Campbell v Mirror Group Newspaper Ltd</i>	91
Summary of main issues	91
 5. Outcome-related fees in other jurisdictions	 94
Introduction	94
Australian jurisdictions – general observations and recent trends	94
<i>Litigation funding companies, class actions and conditional fees</i>	96
Overview of conditional fees in Australian jurisdictions	97
<i>Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd</i>	100
<i>Smits v Roach</i>	100
<i>Legal Practice Act 1996, Victoria</i>	101
<i>Comments of the Law Institute of Victoria</i>	103
<i>Legal Profession Act 1987, New South Wales</i>	103
<i>Legal expenses insurance in Australia</i>	105
Canadian jurisdictions	106
<i>Ontario</i>	107
<i>Joint Committee's proposed regulatory scheme</i>	107
Ireland	109
Mainland China	109

Chapter	Page
Northern Ireland	111
Scotland	112
<i>Speculative fees</i>	112
<i>Conditional fees</i>	112
South Africa	113
 6. Arguments for and against conditional fees and related issues	 115
Introduction	115
Arguments against conditional fees	115
<i>The risk of conflict of interest and unprofessional conduct</i>	115
<i>Increase in opportunistic and frivolous claims</i>	116
<i>Excessive legal fees</i>	117
<i>Reliance on legal expenses insurance</i>	119
<i>Satellite litigation</i>	119
Arguments in favour of conditional fees	120
<i>Access to justice</i>	120
<i>Spread the financial risk involved in litigation</i>	120
<i>Weed out frivolous or weak claims</i>	120
<i>Allow consumers to choose and promote freedom of contract</i>	120
<i>Align the lawyer's interests with those of the client</i>	121
<i>Harmonise the fee structure with other jurisdictions</i>	122
Other related issues	122
Claims intermediaries	122
<i>Regulation of claims intermediaries in England</i>	123
<i>Operation of claims intermediaries in Hong Kong</i>	124
<i>Information revealed at Legislative Council's Panel on Administration of Justice and Legal Services</i>	125
<i>Relevant regulations and rules</i>	126
<i>The Administration's policy on claims intermediaries</i>	127
<i>The impact of allowing legal practitioners to charge conditional fees on claims intermediaries</i>	128
Litigants in person	129
<i>Some statistics on litigants in person</i>	129
<i>Why litigants in person do not obtain legal representation</i>	131
<i>Other surveys – Litigants in Person Project</i>	133
<i>Earlier research by Camille Cameron and Elsa Kelly</i>	135
<i>Australian Law Reform Commission</i>	138
<i>Consumer Council's Consumer Legal Action Fund</i>	140
Impact on barristers	141
Proposals for change	144
 7. Proposals for reform	 145
The Sub-committee's consultation paper	145
The consultation exercise	146

Chapter	Page
Should we allow conditional fees?	146
<i>Views on the proposed conditional fees regime</i>	146
<i>Arguments advanced by those against the introduction of conditional fees</i>	147
<i>Our observations</i>	147
Access to justice	148
<i>Access to justice for the middle-income group</i>	148
<i>Enhanced access to justice</i>	149
<i>Counter-arguments</i>	149
<i>The United Kingdom's House of Commons Select Committee on Constitutional Affairs</i>	150
ATE insurance	152
<i>Problems with ATE insurance in England</i>	152
<i>Prospects of ATE insurance in Hong Kong</i>	152
<i>Conditional fees without ATE insurance</i>	153
Expansion of the Supplementary Legal Aid Scheme	154
<i>Consultees' responses</i>	154
<i>Our views</i>	156
Setting up of a privately-run conditional legal aid fund	157
<i>Views on a conditional legal aid fund</i>	158
<i>England's Civil Justice Council's Report on "Improved Access to Justice – Funding Options & Proportionate Costs"</i>	159
<i>Other bodies in England</i>	159
<i>Our observations</i>	160
<i>Fee arrangements for the proposed fund: conditional fees or normal fees?</i>	160
Should CLAF be run by the Legal Aid Department or should it be run independently?	162
<i>If insurers find conditional fees unpalatable, would CLAF (which utilises both conditional and contingency fees) be successful?</i>	163
Eligibility for CLAF	163
<i>Competition between the schemes</i>	163
<i>Competition with the private sector</i>	164
<i>Small and medium-sized enterprises and limited companies</i>	165
The merits test	166
<i>Appeal panel</i>	167
Mediation	167
<i>Benefits of mediation</i>	167
<i>Adverse costs order for unreasonable refusal to mediate</i>	168
<i>Proposed mechanism</i>	169
<i>Proper safeguards</i>	169
<i>Jurisprudence in England and Wales</i>	170
<i>Mediation's interface with CLAF</i>	170
Types of cases to be covered by CLAF	172
Appeals	174
Contribution rate and fees	174
Conclusion	175

<i>Chapter</i>	<i>Page</i>
8. Summary of recommendations	176
Annex	179
Responses to Consultation Paper on Conditional Fees	

Preface

Terms of reference

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

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

The Sub-committee

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

Prof Edward K Y Chen, GBS, CBE, JP (Chairman)	President Lingnan University
Mr William H P Chan	Deputy Director Legal Aid Department
Mrs Pamela W S Chan, BBS, JP	Former Chief Executive Consumer Council
Ms Agnes H K Choi (from November 2005)	General Manager and Head of Corporate Insurance HSBC Insurance (Asia-Pacific) Holdings Ltd
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 The Hongkong and Shanghai Banking Corporation Ltd
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
Mr Byron T W Leung (<i>Secretary from December 2005 to April 2006</i>)	Senior Government Counsel Law Reform Commission
Ms Cathy Wan (<i>Secretary except from December 2005 to April 2006</i>)	Senior Government Counsel Law Reform Commission

3. The reference has been considered by the Sub-committee and the Commission over the course of 18 meetings between July 2003 and May 2007. In addition, views were exchanged within the Sub-committee at a number of informal meetings and through correspondence.

The consultation exercise

4. In September 2005, the Sub-committee issued a consultation paper to seek views and comments from the community. Over 80 written responses were received and many of these were very substantial. Individuals and organisations that responded in writing are listed in the Annex. We wish to thank these individuals and organisations for their views and their contribution to this law reform project.

Conditional fees are not contingency fees

5. From the responses received by the Sub-committee, it appears that members of the public sometimes confuse conditional fees as implemented in England and Australian jurisdictions with contingency fees as implemented in American jurisdictions.

6. Briefly, conditional fees are based on the traditional basis of calculation of legal fees; the difference is that, if the civil lawsuit is lost, then no legal fee will be charged, whereas if the civil lawsuit is won, then an additional percentage of the traditional legal fees will be charged. In contrast, contingency fees are based on the amount of compensation recovered from a civil lawsuit. If the civil lawsuit is lost, no legal fee will be charged, whereas if the civil lawsuit is won, then a percentage of the compensation recovered will be charged as legal fees.

7. The public's confusion of the two types of fees is understandable, given that the relevant terms are not used in a consistent manner in legal literature.

Terminology

Contingency fees

8. In some literature¹ the term "contingency fees" is given a wide meaning and includes any type of calculation on a "no win, no fee" basis. However, in other contexts, "contingency fees" are taken to mean "percentage fees", whereby the lawyer's fees are calculated as a percentage of the amount awarded by the court. This is the basis adopted in the American jurisdictions. For the purposes of this paper, we use the term "contingency fees" to mean only "percentage fees".

Conditional fees

9. The term "conditional fees" is also sometimes loosely used to include contingency fees. However, in other contexts, and also for the purposes of this paper, "conditional fees" mean fee arrangements whereby, in the event of success, the lawyer charges his usual fees plus an agreed flat amount or percentage "uplift" on the usual fees. 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.

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

Speculative fees

10. Where “speculative fees” are charged, the lawyer is entitled to charge only his or her normal fees 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.

Outcome-related fees

11. In this paper, “outcome-related fees” is used as a general term to include any fee arrangement between a legal practitioner and his or her client in a civil litigation case whereby the legal fees payable would depend on whether the case is successful or not. This basis of charging is sometimes also referred to as “no win, no fee”, and would include contingency fees, conditional fees and speculative fees.

12. An outcome-related fee arrangement is usually allowed only in civil litigation cases, although the scope of application differs amongst jurisdictions. In most jurisdictions, the costs indemnity rule applies, meaning that the unsuccessful party has to pay the costs of the successful party. An outcome-related fee would not relieve the litigant from the risk of an adverse costs order to pay the other side’s legal costs if the litigation is unsuccessful.

Layout of this report

13. The first chapter sets out the sources of litigation finance in Hong Kong, and the rules which apply to the allocation of costs. Chapter 2 examines the application of contingency fees in the USA, while Chapters 3 and 4 look at the development of conditional fees in England and recent problems and litigation there. Chapter 5 turns to the experience of outcome-related fees in a number of other jurisdictions, and Chapter 6 deals with the arguments for and against conditional fees and sets out related issues for discussion. The Commission’s recommendations are set out in Chapter 7, while Chapter 8 contains a summary of the recommendations.

Acknowledgement

14. We wish to express our thanks to Mr Michael Napier, CBE (Member of the Executive Committee) and Mr Robert Musgrove (Chief Executive) of England’s Civil Justice Council, Professor Michael G Faure of Maastricht University (The Netherlands), and Professor Dame Hazel Genn of University College London. They visited Hong Kong between July and September 2006, and provided valuable views and information to the members of the Sub-committee.

15. We would also like to thank Professor Elsa Kelly of the Chinese University of Hong Kong and her team in „The Litigants in Person Project“² who kindly included a question on conditional fees in their survey.

² The project is entitled “Investigation and Analysis of Issues Raised by Self-Representation in the High Court of Hong Kong” (Project No CUHK1191/04 H (2004)[law]) which is fully supported by a grant from the Research Grants Council of the HKSAR. See Chapter 6 for further discussion.

Chapter 1

The costs of litigation

Who pays for litigation?

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

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

1.3 *Legal aid* – The Legal Aid Department in Hong Kong provides assistance to litigants who satisfy the relevant means and merits tests, if their type of case is covered by the legal aid schemes.⁶ The legal aid schemes cover both criminal and civil cases, the latter mainly in relation to matrimonial disputes, miscellaneous personal injury and running-down cases. In 2006, 17,285 applications for civil legal aid were received and 9,229 of them were granted. The Legal Aid Department's expenditure on civil cases was \$303.1 million that year, and \$663.6 million was recovered for the aided persons. As

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

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

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

⁴ As above.

⁵ As above.

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

for criminal legal aid, the same year recorded 3,779 applications, with 2,357 of them granted, for an expenditure of \$113.8 million.⁷

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

1.5 *Legal practitioners* – In jurisdictions which allow outcome-related fees, the litigation costs of unsuccessful cases are borne by the legal practitioners. The level of utilisation of outcome-related fees differs from jurisdiction to jurisdiction. The ALRC observed¹⁰ that in Australia speculative and conditional fee arrangements are commonly used by plaintiffs’ lawyers in personal injury cases. They are also used, although less frequently, for other claims for damages. Occasionally they are used where non-monetary relief, such as a declaration or injunction, is sought. In Scotland, by contrast, it was estimated that only about 1% of all cases are charged on a speculative basis.¹¹ As for the United States, in the absence of legal aid, contingency fees are one of the principal sources of financing for litigation.

1.6 *Claims intermediaries* – These are businesses run by non-legally qualified persons that help clients handle their compensation claims, usually those arising from traffic or work-related accidents. They operate on a “no win, no fee” basis, and usually require payment of 20% – 30% of the compensation received if the claim is successful. Claims intermediaries have proliferated in England, and are operating in Hong Kong. Given that the common law offences of maintenance and champerty are still applicable to Hong Kong, in some circumstances the activities of claims intermediaries might be unlawful. This issue will be discussed in greater detail in Chapter 6 of this paper.

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

⁷ Figures provided by the Legal Aid Department.

⁸ Report No 75 at 38-40.

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

¹⁰ Report No 75 at 36.

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

1.8 *Third party funding* – The use of funding by a third party has become more prevalent in jurisdictions such as England and Australia. Some are commercial funders; although they are not party to the litigation, they substantially control it or stand to benefit from it on a contingency basis. On the other hand, there are “pure funders” who have been described as “*those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business, and in no way seek to control its course*”.¹² Since this form of funding is relatively new, it is discussed further below.

Third party funding

1.9 The developing trend of third party funding has been examined by England’s Court of Appeal in *Arkin v Borchard Lines Ltd*.¹³ The claimant in this case was impecunious and his lawyers acted on a conditional fee arrangement with financial support provided by a professional funder to a maximum of £1.3 million, which was lost when the case failed. The costs incurred by the defendants came to almost £6 million. The Court of Appeal considered the question as to whether an order of costs should be made against a non-party on the ground that the non-party had supported the unsuccessful claimant.

1.10 The Court of Appeal examined *Hamilton v Al-Fayed (No 2)*¹⁴ in which Simon Brown LJ identified the conflict between the desirability of the funded party gaining access to justice on the one hand, and the desirability that the successful defendant should be able to recover his costs on the other. Simon Brown LJ recognised that the costs indemnity rule could deter the bringing of actions that were likely to be lost. The careful assessment of lawyers acting under conditional fee arrangements or the assessment of the Legal Services Commission granting legal aid were likely to achieve the same benefit. However, “pure funders”¹⁵ were less likely to exercise the same careful judgment.

1.11 The Court of Appeal then considered the Privy Council decision *Dymocks Franchise Systems (NSW) Pty Ltd v Todd*¹⁶ which set out the principles derived from English and Commonwealth authorities. The Privy Council pointed out that, although costs orders against non-parties are to be regarded as “exceptional”, the ultimate question is whether in all the circumstances it is just to make the order. Generally speaking, costs orders

¹² *Hamilton v Al-Fayed (No 2)* [2002] EWCA Civ 665, quoted in Privy Council decision *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] UK PC 39. In Hong Kong, Deputy Judge Saunders (as he then was) considered the law of champerty and recognized in *Siegfried Adalbert Unruh v Hans-Joerg Seeberger & Anor*, HCA 6641 of 2000 (unrep), 3rd September 2004 that where a party has a commercial interest in the litigation of another person, it is not unlawful to fund that litigation. This ruling was affirmed on appeal to the Court of Appeal (CACV 298/2004, 7/10/2005) and further appeal to the Court of Final Appeal (FACV 9&10/2006, 9/2/2007).

¹³ [2005] EWCA Civ 655, [2005] 1 WLR 3055.

¹⁴ [2002] EWCA Civ 665.

¹⁵ See definition in para 1.8.

¹⁶ [2004] UK PC 39.

would not be made against “pure funders” as the court would give priority to the public interest in the funded party getting access to justice. However, if the non-party does not merely fund the litigation but also substantially controls it or stands to benefit from it, then justice will ordinarily require that, if the proceedings fail, he will pay the successful party’s costs. The non-party has become “the real party” to the litigation.

1.12 The Court of Appeal pointed out it would be unjust that a funder who purchases a stake in an action for a commercial motive should be protected from liability for the costs of the opposing party. The Court of Appeal said that a just solution must be devised whereby on the one hand a successful opponent is not denied all his costs, while on the other hand commercial funders (who provide a service to those seeking access to justice which they could not otherwise afford) are not deterred by the fear of disproportionate costs consequences.

1.13 The Court of Appeal said that a professional funder should be potentially liable for the costs of the opposing party to the extent of the funding provided. The Court of Appeal was aware that this might cause funders to seek a greater percentage from the compensation and thereby reduce the net recovery of successful claimants. However, overall justice would be better served than leaving defendants in a position where they had no right to recover any costs from a funder whose intervention had enabled the continuation of a claim which had proved to be without merit.

1.14 The Court of Appeal envisaged that this proposed course should cause commercial funders to cap the funds that they contribute to a particular litigation in order to limit their exposure, and this should have a salutary effect in keeping costs proportionate.

Relevant costs rules in Hong Kong

1.15 To assess the impact of the introduction of any outcome-related fees in Hong Kong, it is useful to set out an overview of the relevant costs rules. The word “costs” is sometimes used to denote the remuneration which a party pays to his own solicitor. It also means the sum of money which the court orders one litigant to pay to another to compensate the latter for the expense which he has incurred in litigation. Relevant costs rules in Hong Kong are found in Order 62 of the Rules of the High Court (Cap 4A), which applies to contentious proceedings.¹⁷

Costs to follow the event – the costs indemnity rule

1.16 If in the exercise of its discretion the Court sees fit to make any order as to the costs of, or incidental to, any proceedings, the Court will order

¹⁷ Subject to some exceptions. Order 60, r 2.

the costs “to follow the event”,¹⁸ except when it appears that some other order should be made as to the whole or any part of the costs. This means that the unsuccessful litigant will usually be ordered to pay the legal costs of the successful party,¹⁹ in addition to paying his own legal costs. This rule is referred to as the “costs indemnity rule”,²⁰ and is also the basic costs allocation rule for civil proceedings in the United Kingdom, Canada, Japan and most European countries.²¹ 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.²²

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

- deters vexatious, frivolous or unmeritorious claims or defences;²³
- compensates successful litigants for at least some of the costs they incur in litigating;
- encourages settlement of disputes by adding to the amount at stake in the litigation;²⁴ and
- in jurisdictions which allow outcome-related fees it is regarded as one source for financing litigation, especially where it is certain that the other party has the resources to meet the costs orders.

1.18 Although costs follow the event, the successful litigant seldom recovers his whole outlay. Unless agreed, the costs have to be assessed (or “taxed”) by the court. Unlike the position in England,²⁵ there are five bases for taxation of costs in Hong Kong under the Rules of the High Court: party and party, common fund, trustee, indemnity, and solicitor and own client.

¹⁸ Ord 62 r 3.

¹⁹ However, the amount of costs awarded by the court to the successful litigant seldom repays his full outlay. This concerns the bases of taxation by the court and will be discussed later in this chapter.

²⁰ This is different from “costs on the indemnity basis” which will be discussed later in this chapter.

²¹ ALRC, cited above, at para 4.3.

²² As above.

²³ The costs indemnity rule, however, is also said to deter people with meritorious claims or defences from pursuing them.

²⁴ There is, however, no agreement amongst the studies whether the net settlement rate is higher or lower under the costs indemnity rule than under the American rule. ALRC, cited above, at para 4.6.

²⁵ *Halsbury’s Laws of Hong Kong*, Vol 5, para 90.1223. Costs in England are now assessed either on the standard basis or the indemnity basis: see the English Rules of the High Court (“English RHC”), Ord 62 r 3(4). On the standard basis, a reasonable amount is allowed in respect of all costs reasonably incurred and any doubt which the taxing master has as to whether the costs were reasonably incurred or were reasonable in amount is resolved in favour of the paying party: English RHC, Ord 62 r 12(1). On a taxation of costs on the indemnity basis, all costs are allowed except in so far as they are of an unreasonable amount or have been unreasonably incurred and any doubts which the taxing master may have as to whether the costs were reasonably incurred or were reasonable in amount is resolved in favour of the receiving party: English RHC, Ord 62 r 12(2).

Bases of taxation in Hong Kong

Costs on the party and party basis

1.19 This is the most common basis for the assessment of costs. On a taxation on this basis, all “costs as were necessary or proper for the attainment of justice or for enforcing or defending the rights of the party whose costs are being taxed” will be allowed.²⁶ The principle upon which costs are taxed on this basis is that the successful party should be indemnified against the necessary expense to which he has been put in prosecuting or defending the action, although costs incurred in conducting the litigation more conveniently are not included.²⁷ It has been said that “it is a fiction that taxed costs are the same as costs reasonably incurred”,²⁸ and in the words of Godfrey J in *Wharf Properties Ltd v Eric Cumine Associates*,²⁹ party and party costs are “the bread but not the butter”.

Costs on the common fund basis

1.20 This is a more generous basis than the party and party basis, and “a reasonable amount in respect of all costs reasonably incurred” is allowed.³⁰ In awarding costs which are to be paid out of any fund, except a fund which the party holds as trustee or personal representative, the court may, if it thinks fit, order that the costs be taxed on the common fund basis. Legal aid costs, for example, are assessed on the common fund basis upon taxation as between the legally aided person and the Director of Legal Aid.³¹ Other examples are costs awarded in favour of persons under a disability as a result of a settlement approved by the court, and costs awarded to ensure that the next friend of an infant plaintiff is not out of pocket.³²

Costs on the indemnity basis

1.21 In awarding costs on an indemnity basis, all costs will be allowed except in so far as they are of an unreasonable amount or have been

²⁶ Ord 62 r 28(2).

²⁷ *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1224. See also *Smith v Buller* (1875) LR 19 Eq 473, where such extra costs were described as luxuries which must be paid for by the party incurring them.

²⁸ As above.

²⁹ Unreported; Comm L 48/1985.

³⁰ Ord 62 r 28(4).

³¹ *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1225 and footnote 15. The Legal Aid Ordinance (Cap 91), section 20A(1) provides that on the taxation of costs in proceedings in which an aided person is a party, costs must be taxed for the purposes of the Legal Aid Ordinance according to the ordinary rules applicable on a taxation as between solicitor and client where the costs are to be paid out of a common fund in which the client and others are interested. The effect of this provision is that the costs of any solicitor or counsel retained by the Department of Legal Aid to act on behalf of an aided person are taxed on the common fund basis. This does not affect the other party to the action and the costs as between the legally aided person and the other party are taxed on the usual party and party basis. The party and party taxation between the two parties to the litigation and the common fund taxation as between the legal representative and legal aid are normally conducted at the same time.

³² *Halsbury's Laws of Hong Kong*, Vol 5, para 90.1225.

unreasonably incurred.³³ Any doubts which the taxing master may have as to whether the costs were reasonably incurred or were reasonable in amount must be resolved in favour of the receiving party.³⁴ Circumstances which justify an award on an indemnity basis include cases which are brought with an ulterior motive or for an improper purpose, cases conducted in an oppressive manner, and cases where there has been some deception or underhand conduct on the part of the litigant.³⁵ Costs on an indemnity basis have also been awarded in cases “*where there has been an abuse of the court’s process, contempt of court, and for failure to make full and frank disclosure in an affidavit in support of an ex parte application.*”³⁶

Costs as between a solicitor and his own client

1.22 On a taxation of a solicitor’s bill to his own client,³⁷ all costs must be allowed except in so far as they are of an unreasonable amount or have been unreasonably incurred.³⁸ Costs incurred with the express or implied approval of the client are conclusively presumed to have been reasonably incurred and; where the amount thereof has been expressly or impliedly approved by the client, it is conclusively presumed to have been reasonable in amount.³⁹ On the other hand, costs which in the circumstances of the case are of an unusual nature and such that they would not be allowed on a taxation on a party and party basis are presumed to have been unreasonably incurred until the contrary is shown, unless the solicitor expressly informed his client before the costs were incurred that they might not be allowed.⁴⁰

1.23 On occasions, the court has ordered costs as between opposing parties to be taxed on the solicitor and own client basis, and parties are free to contract that costs between them will be assessed on this basis.⁴¹

Costs on the trustee basis

1.24 In earlier days, trustees and personal representatives were awarded costs on what is now the common fund basis.⁴² Now a more generous basis is made available to them. For costs assessed on the trustee basis, no costs will be disallowed except in so far as they, or any part of their amount, should not, in accordance with the duty of the trustee or personal representative as such, have been incurred by him, and should for that reason be borne by him personally.⁴³

³³ Ord 62 r 28(4A).

³⁴ As above. Also *Halsbury’s Laws of Hong Kong*, Vol 5, para 90.1226.

³⁵ As above, at para 90.1226.

³⁶ As above.

³⁷ Except a bill to be paid out of the legal aid fund pursuant to section 27 Legal Aid Ordinance (Cap 91), or a bill relating to non-contentious business.

³⁸ Ord 62 r 29(1).

³⁹ Ord 62 r 29(2).

⁴⁰ Ord 62 r 29(3). *Halsbury’s Laws of Hong Kong*, Vol 5, para 90.1227.

⁴¹ *Halsbury’s Laws of Hong Kong*, Vol 5, para 90.1227.

⁴² *Halsbury’s Laws of Hong Kong*, Vol 5, para 90.1228.

⁴³ Ord 62 r 31(2). See also *Halsbury’s Laws of Hong Kong*, Vol 5, para 90.1228.

Other costs aspects

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

Counsel's fees

1.26 Every fee paid to counsel must be allowed in full on taxation unless the taxing master is satisfied that it is excessive or unreasonable. In that case, the taxing master must exercise his discretion having regard to all the relevant circumstances.⁴⁴ He must have regard in particular to:

- (a) the complexity or novelty of the matter;
- (b) the skill, specialised knowledge and responsibility required, and the time and labour expended;
- (c) the number and importance of the documents prepared or perused;
- (d) the place and circumstances in which the business is transacted;
- (e) the importance of the matter to the client;
- (f) the amount or value of the money or property involved; and
- (g) any other fees payable to the counsel in respect of other items in the same matter, but only where the work done in relation to those other items has reduced the work which would otherwise have been necessary in relation to the item in question.⁴⁵

Costs of litigant in person

1.27 On a taxation of the costs of a litigant in person, subject to some exceptions, there may *"be allowed such costs as would have been allowed if the work and disbursements to which the costs relate had been done or made by a solicitor on the litigant's behalf."*⁴⁶ Except for disbursements, the amount allowed in respect of any item shall be at the taxing master's discretion and not exceeding two-thirds of the sum which would normally be allowed if the litigant had been represented by a solicitor.⁴⁷ The litigant in person would not normally be allowed more than \$200 an hour in respect of the time reasonably spent by him on the work.⁴⁸

⁴⁴ Ord 62, Sch 1, Part II, para 2(HK)(5).

⁴⁵ Ord 62, Sch 1, Part II, para 1(2).

⁴⁶ Ord 62 r 28A(1).

⁴⁷ Ord 62 r 28A(2).

⁴⁸ Ord 62 r 28A(3).

Legal aid as a source of finance for civil litigation

1.28 Legal aid is available for most types of civil cases⁴⁹ before the District Court, the Court of First Instance, the Court of Appeal and the Court of Final Appeal. It is also available for certain landlord and tenant matters⁵⁰ in the Lands Tribunal, proceedings before the Mental Health Review Tribunal, and in the Coroner's Court if the case is of great public concern.⁵¹ The Legal Aid Department is funded by the Government of the Hong Kong SAR, and the provision for legal costs is not subject to an upper limit. In 2006, the Legal Aid Department's expenditure on civil cases was \$303.1 million, and \$663.6 million was recovered for the aided persons.⁵²

The merits test

1.29 To qualify for civil legal aid, the applicant must pass a merits test and a means test. In assessing the merits of an application, the Director of Legal Aid ("the Director") must be satisfied that the case or defence has a reasonable chance of success. The Director must also be satisfied that it is reasonable that the applicant should be granted aid, and he will take into account all factors which would influence a private client considering taking proceedings.⁵³ 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.⁵⁴ For cases where the benefits cannot be measured in purely monetary terms, the Director will make an objective and careful assessment and due weight will be given to the importance of the case to the applicant.⁵⁵

The means test

1.30 The means test evaluates whether an applicant's financial resources exceed the statutory limit allowed for the relevant legal aid scheme.⁵⁶ Financial resources are taken as an applicant's monthly disposable income multiplied by 12, plus his or her disposable capital.

1.31 Monthly disposable income is the difference between gross monthly income and allowable deductions, which are rent, rates and statutory

⁴⁹ Legal aid is also available for criminal cases tried in District Courts and upwards. It is not available in the Magistrate's Courts for cases other than committal proceedings, given that the Duty Lawyer service is available at the Magistrate's Courts.

⁵⁰ Part II tenancy matters only.

⁵¹ Legal Aid Ordinance (Cap 91), section 5, and Schedule 2 Part I. See also *Halsbury's Laws of Hong Kong*, Vol 17, para 240.331.

⁵² In 2006, total expenditure for criminal cases was \$113.8 million.

⁵³ Legal Aid Department, *Guide to Legal Aid Services in Hong Kong*, at 13.

⁵⁴ Legal Aid Department, cited above, at 14.

⁵⁵ Legal Aid Department, cited above, at 15.

⁵⁶ The three legal aid schemes, being ordinary legal aid, supplementary legal aid and criminal legal aid will be discussed later in this chapter.

personal allowances⁵⁷ for the living expenses of the applicant or his or her dependants.

1.32 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.⁵⁸

Ordinary Legal Aid Scheme

1.33 To qualify for legal aid for civil proceedings under the Ordinary Legal Aid Scheme, the applicant's financial resources⁵⁹ must not exceed \$158,300.⁶⁰ The major types of cases covered by the Ordinary Legal Aid Scheme are:

• family and matrimonial disputes	30% ⁶¹
• miscellaneous personal injury claims	28%
• running down actions	7%
• employees' compensation	9%
• wages claim	2%
• immigration matters	2%
• tenancy matters	2%
• miscellaneous	20%

1.34 Legal aid is not available⁶² for certain proceedings, including:

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

⁵⁷ The statutory personal allowance is periodically adjusted in line with the Consumer Price Index and the Household Expenditure Survey conducted by the Census and Statistics Department. As at February 2006, the statutory personal allowance amounts for a single applicant and an applicant with one dependant are \$3,890 and \$7,090 respectively. The maximum amount is \$16,540 for an applicant with six or more dependants.

⁵⁸ *Ng Ai Kheng Jasmine v Master M Yuen & Legal Aid Department*, HCAL 46 of 2003 (unrep), 8 March 2004. The court decided that the relevant rules do not permit the negative value of a property, being in its true nature a financial liability, to be included in the computation of disposable capital. The amount to be attached to such a property is zero.

⁵⁹ Legal Aid Ordinance (Cap 91), section 5. Please also refer to preceding paragraphs to see how „financial resources“ are calculated.

⁶⁰ Section 5, Legal Aid Ordinance (Cap 91) as amended by LN 97 of 2006. The upper limit of financial eligibility may be waived in meritorious cases involving a possible breach of the Hong Kong Bill of Rights Ordinance (Cap 383) or an inconsistency with the International Covenant on Civil and Political Rights. Legal Aid Ordinance (Cap 91), section 5AA.

⁶¹ Percentage of total expenditure on civil legal aid for 2006/07.

⁶² See Legal Aid Ordinance (Cap 91) Sch 2, Part II.

1.35 A person receiving legal aid will be required to contribute towards the legal costs of the proceedings out of his financial resources and/or the money or property recovered or preserved on his behalf. Applicants whose financial resources are assessed as between \$20,001 and \$158,300 are required to make a contribution on a sliding scale ranging from \$1,000 to \$39,575 (ie 25% of \$158,300).⁶³ Where no contribution is payable, or the contribution paid does not cover the legal costs incurred on behalf of an aided person (including legal costs which cannot be recovered from the opposite party), the Director has a right to recover the costs or any shortfall from any property recovered or preserved in the proceedings. This right is known as the Director of Legal Aid's first charge. If the aided person loses the case, he is liable to pay the assessed maximum contribution or the actual legal costs incurred in the proceedings, whichever is lower.

1.36 The Director is required to pay to the counsel and solicitor acting for an aided person the prescribed fees and costs under the Legal Aid (Scale of Fees) Regulations.⁶⁴ On taxation of costs in proceedings to which an aided person is a party, costs are taxed according to the ordinary rules applicable as between solicitor and client where the costs are to be paid out of a common fund in which the client and others are interested.⁶⁵

Supplementary Legal Aid Scheme

1.37 The Supplementary Legal Aid Scheme was introduced in 1984⁶⁶ to assist members of the so-called "sandwich class" who would otherwise be outside the means test for the ordinary scheme.⁶⁷ This scheme is available for applicants whose financial resources exceed \$158,300 but do not exceed \$439,800. 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. In 2006, 137 applications for supplementary legal aid were received of which 127 applications were approved. Expenditure was \$4⁶⁸ million and \$28.1 million was recovered on behalf of the aided persons.

1.38 Supplementary legal aid is available for a range of cases⁶⁹ including personal injury or death, as well as medical, dental or legal professional negligence where the claim for damages is likely to exceed

⁶³ Schedule 3 to the Legal Aid (Assessment of Resources and Contributions) Regulations, Cap 91B.

⁶⁴ (Cap 91C) pursuant to section 28 of Legal Aid Ordinance (Cap 91).

⁶⁵ Section 20A(1).

⁶⁶ Section 5A Legal Aid Ordinance (Cap 91) added in accordance with section 4, Legal Aid (Amendment) Ordinance 1984 (Ord No 54 of 1984), which came into effect on 1 Oct 1984.

⁶⁷ *Halsbury's Laws of Hong Kong*, Vol 17, para 240.348.

⁶⁸ According to the Legal Aid Department, legal costs and expenses are not recognised as expenditure but treated as receivables offset by receipts from aided persons and from opposite parties.

⁶⁹ Legal Aid Ordinance (Cap 91), section 5A, Sch 3, Part I. The Schedule may be amended by resolution of the Legislative Council.

\$60,000. The scheme also covers claims under the Employees' Compensation Ordinance irrespective of the amount of the claim.

1.39 Where legal aid is granted to an applicant under the Supplementary Legal Aid Scheme, he is required to pay an initial application fee⁷⁰ and an interim contribution for the benefit of the Fund.⁷¹ If he is successful, he will have to make a final contribution calculated as follows:

All costs and expenses incurred on his account plus a "percentage deduction" of, as at February 2006, 10% or 6%⁷² of the damages awarded, depending on whether the case is settled prior to delivery of a brief to Counsel to attend trial.

less

The interim contribution and application fee already paid, and the costs recovered from the opposite party.

1.40 The contribution payable must not exceed the value of the property recovered or preserved in the proceedings,⁷³ and the Director may waive, either in whole or in part, his rights to a contribution where he is satisfied that it would cause serious hardship and it is in all the circumstances just and equitable to do so.⁷⁴

Criminal Legal Aid

1.41 For the purpose of this paper, criminal legal aid will be discussed only briefly. Applicants for criminal legal aid have to pass the means test under the same financial resources criteria as for civil cases.⁷⁵ An applicant charged with murder, treason or piracy with violence can apply to a judge for exemption from the means test and from legal aid contribution.⁷⁶ The Director has a discretion to grant criminal legal aid to an applicant whose financial resources exceed \$158,300 if it is in the interests of justice to do so.⁷⁷

1.42 In the interests of justice, legal representation will be provided to an accused for committal proceedings and for trials in the District Court and the Court of First Instance as long as he passes the means test. However, for criminal appeals, the merits test will apply, except for murder, treason or piracy with violence. There is a statutory requirement to grant legal aid in such cases even if there are no meritorious grounds for appeal.⁷⁸

⁷⁰ \$1,000 as at July 2004.

⁷¹ Legal Aid Ordinance (Cap 91), section 32(1)(a).

⁷² These percentages are provided in LN 224 of 2005, which came into effect on 20.2.2006 by commencement notice LN 21 of 2006.

⁷³ Section 32(2).

⁷⁴ Section 32(3).

⁷⁵ Rule 4 of the Legal Aid in Criminal Cases Rules (Cap 221D).

⁷⁶ Rule 13 of the Legal Aid in Criminal Cases Rules (Cap 221D).

⁷⁷ Rule 15(2) of Cap 221D.

⁷⁸ As above.

Provisions against conditional or contingency fee arrangements in Hong Kong

1.43 In Hong Kong, a solicitor may not enter into a conditional or contingency fee arrangement to act in contentious business.⁷⁹ The restriction stems from legislation, conduct rules, and common law. In *Cannonway Consultants Ltd v Kenworth Engineering Ltd*,⁸⁰ Kaplan J explained that the law of champerty applied in Hong Kong by virtue of section 3(1) of the Application of English Law Ordinance, although the doctrine was of narrow extent. The common law position will be set out in Chapters 3 and 4.

1.44 The Legal Practitioners Ordinance (Cap 159)⁸¹ 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.*”⁸²

1.45 The *Hong Kong Solicitors’ Guide to Professional Conduct* issued by the Law Society of Hong Kong stipulates that “*A solicitor may not enter into a contingency fee arrangement for acting in contentious proceedings.*”⁸³ The Guide’s commentary defines a contingency fee arrangement as:

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

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

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

1.47 As for barristers, they are under a professional duty to observe the rules of conduct set out in the *Code of Conduct for the Bar of Hong Kong*,⁸⁴ which is published by the Bar Council. Paragraph 124 of the Code of Conduct stipulates that “*A barrister may not accept a brief or instructions on*

⁷⁹ *Halsbury’s Laws of Hong Kong*, Vol 17, para 240.125. “Contentious business” includes any business done by a solicitor in any court, whether as a solicitor or as an advocate: Legal Practitioners Ordinance (Cap 159), section 2(1).

⁸⁰ ADRLJ, 1997, at 95-105.

⁸¹ Section 64(1).

⁸² Subsection (b).

⁸³ Principle 4.16.

⁸⁴ Paragraph 6 of the Bar’s Code of Conduct provides that it is the duty of every barrister to comply with the provisions of the Code.

terms that payment of fees shall depend upon or be related to a contingency. ...” It does not, however, prohibit the payment of fees by instalments or payment of interest on fees either as agreed or allowed on taxation.

1.48 Serious failure to comply with the Code of Conduct amounts to professional misconduct and, if so found by a Barristers Disciplinary Tribunal, renders the barrister liable to be punished in accordance with the provisions of the Legal Practitioners Ordinance (Cap 159).⁸⁵ A less serious breach of the Code of Conduct which does not, in the opinion of the Bar Council amount to professional misconduct will be regarded as a breach of professional standards, and may render the barrister liable to be admonished in person or by letter, or to be given appropriate advice as to his future conduct.

⁸⁵ As above, at para 7.

Chapter 2

Contingency fee arrangements in the USA

Introduction

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

2.2 According to the Green Paper prepared by the UK Lord Chancellor's Department in 1989, the State of Maine, for example, prohibits contingency fees entirely, whereas in New York, Michigan and Delaware, statute has overruled initial restrictions against contingency fees.³ Contingency fees are not prohibited in New Jersey, Alabama, Ohio and California, but they are subject to limitations and controls. In another study⁴ in 1992, it was stated that all 50 states allow contingency fee arrangements.

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

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

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

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

⁴ Aranson, cited above.

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

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

⁷ As above, para 2.10.

The percentage contingency fee

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

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

2.6 Understandably, the contingency fee system has come under criticism and initiatives proposing a ceiling on contingency fees in tort actions have been launched. Birnholz¹² noted that in response to the perceived crisis concerning the affordability of health care services throughout the United States, many state legislatures have enacted comprehensive statutory schemes designed to lower medical malpractice insurance premiums and regulate malpractices in litigation. An example of such a scheme is the Medical Injury Compensation Reform Act in California. Typically, these schemes contain provisions that limit the amount an attorney can charge on a contingency fee basis in actions against health care providers. At the time of the article, New Jersey allowed fees amounting to 33% of the first \$250,000 recovered, 25% of the next \$250,000, and 20% of the next \$500,000. The fees allowed in California were 25% of amounts recovered between \$100,000 and \$500,000, and 15% of amounts above \$600,000.

2.7 Critics of the US contingency fee system have described it as nothing more than a “lottery ticket” that brings the “*jury system into contempt*” and creates a “*feeling of antagonism between aggregated capital on the one side and the community in general on the other ...*”.¹³ Aranson¹⁴ is one such critic of the American contingency fee system.

⁸ As above, para 2.12.

⁹ As above.

¹⁰ Aranson, cited above.

¹¹ 729 S.W. 2d 768 (Tex. App. – Houston [1st Dist.] 1987).

¹² Birnholz, cited above.

¹³ “The Contingent Fee Business”, 24 Alberta Law Journal 24, 26 (1881), quoted in Aranson, cited above.

¹⁴ Aranson, cited above.

Criticisms of contingency fees

2.8 In an article entitled *The United States Percentage Contingent Fee System: Ridicule and Reform From an International Perspective*,¹⁵ Aranson observed that although contingency fees had opened the courthouse doors to the poor, they had attracted much criticism. Aranson did not question the validity of outcome-related fees (and, indeed, almost every commentator agreed that some form of outcome-related fee was essential to facilitate access to justice in the United States) but instead proposed that reforms should be made to maintain the advantages and mitigate the disadvantages of the contingency fee system.¹⁶

2.9 Aranson envisaged that, because of the percentage basis of the fee, lawyers might be more likely to choose to represent clients with frivolous claims, to pursue cases with their own interests in mind rather than their clients' interests, and to extract excessive fees at the conclusion of the case.

Frivolous litigation

2.10 Aranson pointed out that, if a lawyer took several cases on a contingency fee basis, the cost of a losing frivolous case would be offset by the rewards from frivolous cases that prevailed. Lawyers could subsidise baseless cases by using funds from contingent cases in which they had succeeded to cover the litigation costs. Hence, lawyers could gamble compensation from frivolous cases on the bet that a baseless claim would be profitable because of the pressure on the defendant to settle. The greater the extent to which compensation exceeded the normal hourly fee, the greater the chance of abuse. In Aranson's view the chance of abuse was therefore greatest with the percentage contingency fee.¹⁷

2.11 Aranson also commented that the contingency fee system offered lawyers the most tempting incentive to initiate cases for their settlement value, clogging the legal system with litigation and resulting in costly delays for all. When companies were "blackmailed" into paying settlements for unmeritorious claims, consumer costs increased and the poor would also suffer in the end.¹⁸

Conflict of interest

2.12 Although proponents of contingency fees claimed that they aligned the interests of lawyer and client because each wanted the highest recovery possible, Aranson pointed out that a conflict arose as the lawyer wanted the highest recovery in the shortest amount of time possible, while the

¹⁵ Allison F Aranson, *Texas International Law Journal* (Summer 1992), 27 Tex Int'l LJ 755.

¹⁶ Aranson, cited above, at 757.

¹⁷ Aranson, cited above, at 762.

¹⁸ As above.

client simply wanted the highest recovery, regardless of the amount of time the lawyer spent on the case.

2.13 The client's and the lawyer's interests were aligned only when the case promised a large award from a jury trial. Yet the vast majority of cases engaged on a contingency fee basis settled. By settling a case quickly, a lawyer could receive a large fee without expending much time on the case. Because a case which settled could be dealt with more quickly than one which went to trial, there was an additional incentive for the lawyer to take on a large number of contingency fee cases to maximise profits.

2.14 Aranson quoted Herbert M Kritzer,¹⁹ an expert on the effect of fee arrangements on lawyers' work habits, who found that lawyers were not motivated purely by self-interest and profit maximisation. Rather, such incentives were tempered with "*competing values including professional standards and a sense of responsibility to the client.*"²⁰ Aranson commented that the temptation for unethical conduct should not go unwatched. Although lawyers should not be expected to behave altruistically, the fee system should at least make it less profitable for the lawyer to travel down an unethical path.²¹

Excessive fees

2.15 Aranson argued that contingency fees were detrimental to the client's interest, as they resulted in excessive fees being paid to the lawyer at the conclusion of the case. A lawyer's fees could be regarded as excessive if they were not justified in terms of, first, the time and effort expended by the lawyer and, second, the risk of no payment.

2.16 In terms of the time and effort expended on the case, Kritzer's study revealed that a lawyer hired on a contingency fee basis was likely to work seven hours less on a typical \$6,000 claim than a lawyer hired on an hourly basis. Those seven hours represented nearly 22% of the time spent on a typical \$6,000 case.

2.17 In terms of the risk of no payment, Aranson pointed out that over 90% of cases taken on a contingency fee basis settled before trial, and the defendant won in only 50% of those that went to trial. Indeed, the lawyer risked receiving no fee in only 5% of cases.

2.18 Aranson commented that, rather than reflecting the lawyer's investment of his time and effort and the risk taken, the excessive fees reflected the scarcity of information available to clients searching for adequate representation. Clients did not possess the necessary information to compare the services rendered by different lawyers. In a survey by the American Bar Association, it was found that 80% of those surveyed believed

¹⁹ Herbert M Kritzer, *The Impact of Fee Arrangement on Lawyer Effort* (1985), 19 Law & Soc'y Rev 251, 272.

²⁰ Kritzer, above cited, at 253.

²¹ Aranson, above cited, at 766.

that people did not seek legal advice because of the difficulty of identifying competent lawyers.²² The client, who knew little about the cost and nature of legal services, would usually assume that the lawyer he had chosen was competent and charged a fair fee.²³

2.19 In mass tort cases, the fact that the lawyers could repeat the same arguments for multiple plaintiffs incurred low marginal costs and offered a chance for even further pecuniary gain.

2.20 Statistics show that in the average tort lawsuit with a contingency fee arrangement, approximately 24% of the total award goes to the plaintiff's legal fees and expenses. In contrast, the defendant's legal fees and expenses total approximately 18% of the total compensation.²⁴ It is small wonder that 97% of United States lawyers were found to accept personal injury cases on a contingency fee basis only, regardless of the client's ability to pay the lawyer's standard hourly rate.²⁵

Advantages of contingency fees

2.21 Although the contingency fee system operating in the United States of America is generally branded as the scapegoat giving lawyers a bad reputation it is defended in America as the only system yet devised that permits the ordinary citizen equal access to the courts, as well as guaranteeing the availability of counsel equally skilled and knowledgeable as those available to the monied and corporate classes.

Other unique features of the American civil justice system

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

Costs do not follow the event

2.23 The basic costs allocation rule in most jurisdictions is that the losing litigant must pay not only his or her own costs, but also those of the winner, or at least part of the winner's costs. We have pointed out²⁶ that this costs indemnity rule is adopted for civil proceedings in Canada, Japan, Hong

²² Peter H Schuck, *Consumer Ignorance in the Area of Legal Services* (1976), 43 Ins Couns J 568, 568. Quoted by Aranson at 769.

²³ Richard M Birnholz, *The Validity and Propriety of Contingent Fee Controls* (1990), 37 UCLA L Rev 949, 954. Quoted by Aranson at 770.

²⁴ Kakalik & Pace, *Costs and Compensation Paid in Tort Litigation* (1986) at 71. Quoted by Aranson at 772.

²⁵ Crovitz, *Contingency Fees and the Common Good*, Wall St J 21 July 1989, at A14.

²⁶ See Chapter 1 above.

Kong, the United Kingdom and most European jurisdictions, including Austria, Belgium, Denmark, France, Norway, Spain and Sweden.²⁷

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

2.25 There is also one way fee shifting in some American jurisdictions. Some State legislatures have introduced laws that allow a successful plaintiff to recover his costs, but a successful defendant is not allowed to do so.²⁸

Trial by jury

2.26 In the United States, the right to jury trial in a civil case is constitutionally protected. It is a unique feature of the American civil justice system that a plaintiff is entitled to a jury trial in almost any case involving personal injuries. The jury decides not only the issue of liability, but also that of damages. Since juries generally have no technical training or prior litigation experience, they may be subject to influence by attorneys in ways that judges are not.²⁹

Punitive damages

2.27 Punitive damages are also within the jury's discretion in many states, and the readiness of American courts and juries to award punitive damages is another reason for the high awards in the United States.³⁰ The problem has been compounded by the extensive publicity given to the initial awards and the relative under-reporting of those cases where the quantum has been reduced on appeal. This would tend to affect jury sensibilities and fuel the expectations of would-be claimants and their lawyers.³¹

Specialised plaintiff bar

2.28 There is a division between lawyers who specialise in acting for plaintiffs on a contingency fee basis and defence lawyers who charge hourly

²⁷ See Australian Law Reform Commission, *Costs shifting – who pays for litigation* (1995, Report No 75), at Appendix C.

²⁸ See for example Civil Rights Attorney's Fees Awards Act 42 US CA 1988 (1982); Equal Access to Justice Act 20 US CA 2412 (1988).

²⁹ D Debusschere & J L Hom, "United States" in D Campbell (ed), *International Product Liability* (1993), at 564. HKLRC, *Report on Civil Liability for Unsafe Products* (1998), para 6.10.

³⁰ Ontario Law Reform Commission, *Report on Products Liability* (1979), at 75. HKLRC, cited above.

³¹ Stapleton, *Product Liability* (1993), at 78. HKLRC, cited above.

rates.³² The lucrative nature of the contingency fee system for the more aggressive specialist plaintiffs' bar encourages the filing of speculative actions.³³

Precedents not binding

2.29 The American courts openly embrace a high level of judicial law-making and a flexible approach to precedents.³⁴ To American judges, predictability and certainty in the law seem to count for less than perceived justice in the individual case.³⁵

Discovery

2.30 In the United States, pursuant to Rule 26(b)(1) of the Federal Rules of Civil Procedure,³⁶ subject to some limitations, parties may obtain discovery regarding any matter, not privileged, that is relevant to the claim or defence of any party, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. For good cause, the court may order discovery of any matter relevant to the subject matter involved in the action. Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence. This approach opens the door to "fishing expeditions" to uncover new avenues of liability not originally contemplated. It has been commented that the American process of discovery is such that it is possible for an action to be commenced without any substantive evidence, and the process of discovery can be used to find both evidence and defendant.³⁷

2.31 In Hong Kong, by contrast, the extent of the right of discovery is more restrictive, especially in respect of discovery against those who are not parties to the proceedings. By virtue of Order 24 rule 7A of the Rules of the High Court (Cap 4A), which applies only to personal injury cases, the application has to be supported by an affidavit which must specify or describe the documents in relation to which the order is sought and show that the documents are relevant to an issue arising in the proceedings. Discovery of documents or facts against non-parties is not normally available.³⁸

³² Australian Law Reform Commission, *Product Liability* (1989, Report No 51), at 10. HKLRC, cited above.

³³ HKLRC, cited above.

³⁴ Stapleton, cited above, at 75 and 79. HKLRC, cited above.

³⁵ As above, at 71. HKLRC, cited above.

³⁶ Including amendments effective 1 December 2000.

³⁷ Australian Law Reform Commission, cited above, at 10. HKLRC, cited above.

³⁸ W S Clarke, *Hong Kong Civil Court Practice* (2000, Butterworths), at 175.

Absence of legal aid

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

Class actions

2.33 The United States' civil procedure caters for class actions which allow a large group of plaintiffs to pursue a common claim against one or more defendants. Class actions are distinct from typical joinder situations in both the number of litigants involved and in the manner in which most class members participate in the case.³⁹ Rule 23 of the Federal Rules of Civil Procedure contemplates that the class of litigants will be represented both by counsel and by "class representatives" (ie active members of the class who make many decisions for the entire class).⁴⁰

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

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

Non-specific pleadings

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

2.36 In Hong Kong, by contrast, pleadings have to be specific. Order 18 rule 12 of the Rules of the High Court (Cap 4A) requires that every pleading must contain the necessary particulars of any claim, defence or other matter pleaded.⁴¹

³⁹ Baicker-McKee, *Federal Rules of Civil Procedure* (2001, West Group), at 386.

⁴⁰ As above.

⁴¹ See also *Aktieselskabet Dansk Skibsfinansiering v Wheelock Marden* [1994] 2 HKC 264 (CA), at 269E-270E, *per* Bokhary JA, which set out the general requirement of pleadings.

New York State

2.37 Normally, the court will not look into the fee agreements between the lawyer and the client, but in some States, particularly in New York State, the lawyer is required to file with the court a schedule setting out the retainer details as to who referred the case to the lawyer, and the basis of the contingency fee agreement. When the case is concluded, the lawyer is required to file a closing statement as to costs.

2.38 The court supervision is to ensure that there is no abuse in the fee agreements. It has been pointed out that contingency fees should be calculated on the basis of damages less disbursements, with the contingency fee based on the net amount. It would be an abuse to calculate the contingency fee on the gross amount of the damages, and then to deduct disbursements from the remainder of the damages.

Conclusion

2.39 It seems, therefore, that the way in which contingency fees are operating in the American civil litigation system flows from the interplay of a number of factors. What may be considered to be the undesirable elements of the US system, such as the high level of litigation and the extreme level of awards, go wider than contingency fees and have their roots in some fundamental features of the US civil justice system. It is not possible, for instance, to attribute the high level of litigation to contingency fees or any one factor alone. In fact, when Aranson criticised the American percentage contingency fee system⁴² he made it clear that he believed “*some form of contingency fee system is essential to facilitate access to the justice system in the United States.*” He found England’s conditional fee system an attractive model which could maintain the present advantages and mitigate the disadvantages of the percentage contingency fee system. The next two chapters will examine the development of conditional fees in England and the problems encountered.

⁴² See para 2.7 above.

Chapter 3

Legislative changes in England concerning conditional fees

Introduction

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

Maintenance and champerty

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

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

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

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

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

⁴ As above.

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

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

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

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

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

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

Criminal Law Act 1967

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

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

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

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

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

¹⁰ As above.

Commission¹¹ which found that “*maintenance and champerty are a dead letter in our law*” and:

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

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

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

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

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

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

¹² As above, at paras 7, 15.

¹³ Section 14(2).

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

¹⁵ M Zander, cited above, at 2.

¹⁶ [1975] QB 373.

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

¹⁸ [1975] QB 373 at 393.

Solicitors Act 1974

3.9 Fee agreements to act on an outcome-related basis are also prohibited by section 59 of the Solicitors Act 1974. Subject to the recent changes in the law described below, they are proscribed in respect of proceedings in England and Wales by rule 8 of the Solicitors Practice Rules 1988, which provides that:

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

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

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

The Royal Commission on Legal Services 1979²¹

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

*“The fact that the lawyer has a direct personal interest in the outcome of the case may lead to undesirable practices including the construction of evidence, the improper coaching of witnesses, the use of professionally partisan expert witnesses, especially medical witnesses, improper examination and cross-examination, groundless legal arguments, designed to lead the courts into error and competitive touting.”*²²

Green Paper on Contingency Fees 1989²³

3.11 The 1989 Green Paper on *Contingency Fees* (the 1989 Green Paper) was devoted wholly to the subject of outcome-related fee arrangements. The 1989 Green Paper examined the various arguments for and against the introduction of outcome-related fees including the risk of

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

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

²¹ The Benson Commission, (1979, Cmnd 7648).

²² Para 16.4.

²³ Lord Chancellor’s Department, Cmnd 571, cited above. Prior to this in 1988, a Report by the Review Body on Civil Justice (Cmnd 394, at paras 384-389) encouraged the Lord Chancellor to review the matter.

conflict of interest, the United States experience, access to justice and allowing more choice to the consumer.

Options set out in the 1989 Green Paper

3.12 Having examined the arguments for and against outcome-related fees, the 1989 Green Paper considered several possible options:

- (i) Adopt the speculative basis, as was already possible in Scotland. A solicitor would be able to recover only his normal taxed costs in the event of success, and nothing if the proceedings were not successful. If it were necessary to instruct counsel, this would again be on a speculative basis, with the counsel's clerk being informed of the basis before the brief was accepted. This basis, unsurprisingly, had not been widely adopted in Scotland, and information received from the Faculty of Advocates indicated that only about 1% of the Faculty's caseload had been conducted on a speculative basis.²⁴
- (ii) The second option modified the speculative basis by adding a percentage to the taxed costs in the event of success. The extra percentage ("the uplift") could be fixed by reference to the amount of taxed costs, rather than by reference to the amount of damages or property recovered. In this way, the lawyer would not have a direct financial interest in the level of damages recovered.²⁵ Fees on this basis would eventually be called conditional fees.
- (iii) The third option, termed a restricted contingency basis, was to allow contingency fees in the American sense but to restrict the percentage of the damages that could be taken by the lawyers, depending on the stage the proceedings had reached.²⁶
- (iv) The fourth option, an unrestricted contingency basis, would be to allow contingency fees as a percentage of the damages without any upper limit. The Green Paper considered that this option would not be in the public interest due to the unequal bargaining power of the lawyer and his client.

Responses to the 1989 Green Paper

3.13 The Bar was strongly opposed to any change, primarily on ethical grounds.²⁷ The Law Society was also opposed to contingency fees on

²⁴ Paras 4.1 and 4.3.

²⁵ Paras 4.4-4.5.

²⁶ Para 4.6.

²⁷ General Council of the Bar, *Quality of Justice : The Bar's Response* (1989), at 258-64. Cited by M Zander, cited above, at note 31.

ethical grounds. However, it supported the second option which is essentially a conditional fee.²⁸

3.14 Six months after the publication of the 1989 Green Paper, the White Paper on *Legal Services: A Framework For The Future*²⁹ was issued, which subsequently resulted in the 1990 Act.

Courts and Legal Services Act 1990

3.15 Section 58(3) of the Courts and Legal Services Act 1990 gave effect to the White Paper by legitimising conditional fee agreements, so that a conditional fee agreement “*shall not be unenforceable by reason only of its being a conditional fee agreement*”.³⁰ 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 1995³¹ and Conditional Fee Agreements Order 1995³²

3.16 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.

²⁸ Law Society, *Striking the Balance*, The Final Response of the Council of the Law Society on the Green Paper (1989). Cited by M Zander, cited above, at note 32.

²⁹ Cm 749 (1989).

³⁰ According to M Zander, cited above, at 4, this provision has the effect of preserving the solicitor's rights against his client and of preserving the client's right to recover costs from the other side despite the fact that the agreement was still maintenance and champertous. If a conditional fee agreement remains maintenance, the lawyers could be liable to the successful party for his costs if his client is uninsured against the loss and cannot pay the winner's costs. According to Michael J Cook, *Cook on Costs* (2002), at 472, in 1999 Lord Spens's action against the Bank of England collapsed as he could not afford the premium of the £100,000 for ATE insurance to cover the anticipated costs of £750,000. His solicitors refused to continue for fear that they might be held liable as maintainers of the litigation.

³¹ (SI 1995/1675).

³² (SI 1995/1674).

- The maximum allowable success fee was set at 100% of the solicitor's normal costs.
- Solicitors and barristers were not allowed to claim a percentage of the damages awarded.
- Solicitors were expected to fund all necessary disbursements themselves as a business overhead. Such disbursements could include:
 - (a) the cost of obtaining insurance for the client against the risk of his losing and having to pay costs to the other side,
 - (b) the court fees,
 - (c) the cost of obtaining expert reports,
 - (d) the payment of counsel's fees,³³ unless counsel was also willing to act under a conditional fee agreement.
- Disbursements would not be eligible for any uplift.
- A losing party who was liable to pay costs would not have to pay any extra because his opponent had a conditional fee agreement, under which his solicitors and/or counsel's fees were subject to an uplift. In other words, the entire uplift or success fee would have to be funded by the client from any damages recovered.
- The Law Society recommended at that time that solicitors' uplifts be capped when they reach 25% of the damages recovered and the Bar Council recommended that counsel's uplifts be capped when they reach 10%.

3.17 The uplift by way of success fees that lawyers could charge was up to 100% of the fees.³⁴ This was the subject of fierce political debate. Zander has pointed out that the success fee is a percentage of the solicitor's base costs, excluding disbursements; and whilst base costs cover overheads as well as profit, the success fee is all profit.³⁵ On the other hand, the extra profits might be needed to cover the cases that were lost. It was reported that two firms acting on conditional fee agreements against tobacco companies

³³ In England & Wales, it is possible to have a time-cost barrister working with a conditional fee solicitor in the same case. Where the barrister has a conditional fee agreement, if the client wins, the barrister's fee is the solicitor's disbursement which can be recovered from the opponent. The client must pay the barrister's uplift fee shown in the separate conditional fee agreement the solicitor makes with the barrister. The solicitor will discuss the barrister's uplift fee with the client before instructing the barrister. If the client loses, he pays nothing. In cases where the barrister does not have a conditional fee agreement, if the client loses and has not been paying the barrister's fees on account, the solicitor is liable to pay them. Because of this, the solicitor adds an extra success fee if the client wins. This extra success fee is not added if the client has been paying the barrister's fees on account. If the client wins, he is liable to pay the barrister's fees.

³⁴ At first the Lord Chancellor's Department's Consultation Paper suggested that the success fee should be restricted to 10% of normal costs. The Law Society argued that raising the success fee to 100% would enable a lawyer to break even if half of the cases taken on a conditional fee basis were successful.

³⁵ M Zander, cited above, at 4.

had abandoned the case, and the cost to one of the firms was some £2.5 million.³⁶

3.18 The obvious danger area is in the calculation of the success fee and any cap on fees. In fact, the Regulations do not specifically require the lawyer to fix the percentage of success fee by reference to the risk of losing the case. Evans suggested that the recommended formula for calculating the success fee should be: $(F \div S) \times 100 = SF$, where F = prospects for failure, S = prospects of success, and SF = the success fee. So, a case with a 75% prospect of success would attract a success fee of $(25 \div 75) \times 100 = 33.33\%$.³⁷ The computation is obviously subjective and clients would not be in a position to evaluate the solicitor's assessment of the prospects of success.

3.19 The 1995 Regulations list out the detailed elements³⁸ that must be included in a conditional fee agreement if it is to be enforceable. The Regulations also state that the contract must confirm that the solicitor has verbally discussed specific points with the client immediately before signing. These are:

- (a) whether the client might be entitled to legal aid in respect of the proceedings to which the agreement relates, the conditions on which legal aid is available and the application of those conditions to the client in respect of the contemplated proceedings;
- (b) the circumstances in which the client may be liable to pay the fees and expenses of the legal representative in accordance with the agreement;
- (c) the circumstances in which the client may be liable to pay the costs of any other party to the proceedings; and
- (d) the circumstances in which the client may seek taxation of the fees and expenses of the legal representative and the procedure for so doing.

³⁶ The Times (27 February, 1999) and Law Society Gazette (3 March 1999). Cited by M Zander, cited above.

³⁷ John C Evans, England's New Conditional Fee Agreements : How will they change litigation? Defence Counsel Journal July 1996 (63 Def Couns J 376).

³⁸ (a) The particular proceedings or parts of them to which it relates, including whether it relates to any counterclaim, appeal or proceedings to enforce a judgment or order; (b) the circumstances in which the legal representative's fees and expenses or part of them are payable; (c) what, if any, payment is due (i) on partial failure of the specified circumstances to occur (ie if the case is lost); (ii) irrespective of the specified circumstances occurring (ie outlays/disbursements); and (iii) on determination of the agreement for any reason; and (d) the amount or amounts payable in accordance with (b) or (c), above, or the method to be used in calculating the amount or amounts payable, and in particular whether the amount payable is limited by reference to the amount of any damages that may be recovered on behalf of the client (that is, a "cap").

After-the-event insurance

3.20 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 in England led to the development of "after-the-event insurance" (ATE insurance).³⁹ Different ATE insurance products have different features: for some, the premium is payable at the outset, while for others the premium is deferred to the conclusion of the case. Even the premium is conditional upon success for some ATE insurance. Some ATE insurance would cover a litigant's own counsel's fees and disbursements. As at December 2006, there were about 30 companies advertising themselves as providers of ATE insurance, but just five were actual insurers.⁴⁰ The other providers or brokers of ATE insurance would charge different rates of commission, with commissions of up to 50% of the gross premium not unheard of.⁴¹ The ATE insurance market is not particularly stable, and ATE insurance providers enter or leave the market from time to time. Amongst the 30 ATE insurance products offered on the market as at December 2006, only two⁴² have been available since the launch of conditional fees in 1995, while 21 have been available since 2000. It is reported that some ATE providers change insurers frequently, and one ATE provider is on its fourth ATE insurer since 2000.⁴³ Senior Costs Judge Peter Hurst has commented⁴⁴ that the ATE insurance market is very young and has not settled down, and some of the early entrants lost a great deal of money. He added that if the ATE market collapses, the conditional fee regime will also collapse, and it would be necessary to consider doing away with the costs indemnity rule. He pointed out that litigation in England has operated for hundreds of years on the costs indemnity rule and there is a strong argument for retaining the rule to put a damper on frivolous claims and time-wasting. Judge Hurst commented that the system now completely protects claimants and the particular brake on claims has been taken away.

3.21 When conditional fees were launched in 1995, Lexington Insurance Co,⁴⁵ offered a service called Accident Line Protect⁴⁶ to members

³⁹ As opposed to before-the-event Insurance (BTE) which covers a range of legal problems as "add ons" to house insurance or motoring policies. These policies usually cover lawyers' fees, court fees, costs of witnesses and experts plus costs of the opponent if the insured is ordered to pay them. See M Zander, cited above.

⁴⁰ Allianz Cornhill, DAS, Elite, Lamp, and Mount Grace.

⁴¹ E Gilbert, *Litigation Funding*, Issue 46 Dec 2006.

⁴² Accident Line Protect, Law Assist/Litigation Protection.

⁴³ E Gilbert, cited above.

⁴⁴ *Litigation Funding*, Issue 44 Aug 2006.

⁴⁵ It now seems that Accident Line Protect is provided by Abbey Legal Protection.

⁴⁶ The following types of cases were automatically covered by Accident Line Protect: (1) Plaintiffs' personal injury cases arising anywhere in the European Union, so long as proceedings are brought in England and Wales. Personal injury is defined as "*any disease and any impairment of a person's physical or mental condition for which damages may be claimed*"; (2) Mixed cases in which a personal injury claim is being run in conjunction with another related claim for example, property damage to the vehicle; and (3) Actions against other solicitors for the alleged negligent handling of a personal injury case. Some types of cases have to be referred to the insurer for prior approval: (1) Multi-party actions involving ten or more claims; (2) Claims for psychiatric injury "*where there is no recognised cause of action in English law*"; (3) Where a personal injury claimant is seeking additional damages for further injuries allegedly caused by

of the Law Society. This was intended as a quality control provision and negated the need to screen every applicant on a routine basis.⁴⁷ 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.⁴⁸ By December 2006, Accident Line Protect no longer offered disbursement funding.

Counsel's fees

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

3.23 The Law Society of England and Wales recommended that the total of the solicitor's and counsel's success fees combined should not exceed 25% of the damages recoverable.⁴⁹ However, this recommendation is only persuasive. The "cab rank" rule does not apply to conditional fee agreements and counsel cannot be compelled to accept instructions on a conditional fee basis.⁵⁰ Chambers as a whole, or certain counsel within chambers, may agree to do conditional fee work, and may agree to accept returns in conditional fee agreement cases among themselves so that suitable replacement counsel can be found within the same chambers to accept the case on a conditional fee agreement basis.⁵¹

Evaluation of conditional fee agreements in 1997

3.24 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 Report⁵² found that, within 15 months of their introduction, conditional fee agreements had become an established method of payment for personal injury litigation.⁵³

the negligent medical treatment of the claimant's original injury; (4) An appeal; and (5) Where a new firm takes over the handling of a client's case in which the original solicitor was acting under a conditional fee agreement. See John C Evans, cited above.

⁴⁷ John C Evans, cited above.

⁴⁸ Litigation Funding, August 2004 Issue 32 at 10.

⁴⁹ *Greenslade on Costs*, at B-038.

⁵⁰ *Greenslade*, cited above, at B-039.

⁵¹ As above.

⁵² Written by Stella Yarrow. PSI is an independent research organisation undertaking studies of economic, industrial and social policy and the workings of political institutions.

⁵³ Yarrow, at Chapter 2.

Another source⁵⁴ also found that the conditional fee arrangement was “*generally judged a success*”.

3.25 The PSI Report found that in three-quarters of the cases surveyed, the main reason for taking out a conditional fee agreement was that the client was ineligible for legal aid and could not afford to pay out of his own resources. The indications were that conditional fees were indeed widening access to justice.⁵⁵

3.26 In relation to earlier concerns that the 100% maximum permissible uplift or success fee would become the norm, the PSI Report found that the average uplift was 43%, well below the maximum figure. In three-quarters of the cases surveyed, the uplift was under 50%. The survey also showed that the average uplift increased as the chances of success decreased. Road traffic accidents, for example, had the lowest average uplift of 33%, with the most common uplift in this category falling within the 1-20% range. The PSI Report, however, found that there were a number of cases where the uplift and prospect of success did not seem to bear any correlation. It pointed out that taxation was available as a protection for clients against excessive uplifts, and so was the voluntary cap of 25% of the damages recommended by the Law Society.⁵⁶

3.27 As for ATE insurance, this had been taken out in 99% of cases, and Accident Line Protect insurance was used in almost all cases. Accident Line Protect dominated the market due to the significant competitive advantage of its low premium.⁵⁷ Solicitors registered with Accident Line Protect were required to offer only this policy in all eligible cases in order to prevent only the weak cases being insured. Accident Line Protect was offered only to solicitors on the Personal Injury Panel. This restriction could potentially deter other solicitors from entering the conditional fee market, though it encouraged clients to use solicitors with expertise in the field.⁵⁸

3.28 As for the concern that conditional fees would lead to a vast increase in spurious litigation, the PSI Report found that it had not materialised. The Report pointed out that there was little incentive for lawyers to pursue litigation under a conditional fee agreement which had little prospect of success. The survey found that solicitors were choosing to take only a tiny number of cases with a less than 50% chance of success. Of the cases surveyed, only one per cent fell into this category, with the vast majority – 82% – being estimated as having a good or very good chance of success.⁵⁹ There was also no real evidence of “ambulance chasing” or improper marketing by solicitors. However, the widening of solicitors’ advertising rules, coupled with the raised profile for this type of case, and entry into the market of commercial organisations, such as Accident Line Protect insurance, combined to bring advertisements for claims work to television and radio for the first time.

⁵⁴ B Main & A Peacock, *What price civil justice?* (1998), University of Edinburgh.

⁵⁵ Yarrow, at Chapter 3.

⁵⁶ Yarrow, at Chapter 4.

⁵⁷ However, by 1999, the premium rose to over £3,000 for the same policy.

⁵⁸ Yarrow, at Chapter 5.

⁵⁹ As above.

Further reforms 1998 – 2000

3.29 After an encouraging start, the conditional fees system underwent further reforms from 1998 to 2000. Originally, conditional fee agreements were restricted to personal injury, insolvency and human rights cases. In October 1997, the Lord Chancellor, Lord Irvine:

*“... caused consternation in the legal world by announcing that legal aid for the indigent would be abolished for all damages and money claims on the ground that they could now be financed through conditional fee agreements.”*⁶⁰

Consultation Paper on “Access to Justice with Conditional Fees” 1998⁶¹

3.30 The 1998 Consultation Paper stated that by the end of 1997, after conditional fees had been made available for some 30 months, around 34,000 policies had been issued, with their use increasing as lawyers developed their expertise in this area.⁶² The Government could see no good reason to continue to prohibit the wider use of conditional fees, and proposed to allow conditional fee agreements to be entered into in any proceedings other than those categories proscribed by statute (ie family and criminal cases).⁶³

3.31 The 1998 Consultation Paper further stated that the Government was minded to amend the law to allow the uplift or success fees and the insurance premium to be recoverable from the losing party.⁶⁴ The reason given was that both types of costs were incurred directly because the loser had put the successful party to the cost of taking proceedings, and they should be recoverable in the same way as other costs.

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

⁶⁰ M Zander, cited above.

⁶¹ Issued by the Lord Chancellor’s Department, March 1998.

⁶² Para 2.5.

⁶³ Paras 2.6-2.7.

⁶⁴ Para 2.17.

Conditional Fee Agreements Order 1998

3.33 In 1998, a new Conditional Fee Agreements Order⁶⁵ revoked the 1995 Order. Conditional fee agreements were to be permissible in all civil proceedings other than family and criminal cases. Article 4 of the new Order retained 100% as the maximum permitted percentage increase.

Access to Justice Act 1999

3.34 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. Family work and criminal work remained outside the scope of the conditional fee regime.⁶⁶
- (c) The successful litigant can recover from the losing litigant the ATE insurance premium payable for an insurance policy against the risk of having to pay the opponent's costs.⁶⁷
- (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,⁶⁸ subject to taxing down by the Court.

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

- *“ensure that the compensation awarded to a successful party is not eroded by any uplift or premium – the party in the wrong will bear the full burden of costs;*
- *make conditional fees more attractive, in particular to defendants and to plaintiffs seeking non-monetary redress – these litigants can rarely use conditional fees*

⁶⁵ (SI 1998/1860).

⁶⁶ Section 27(1).

⁶⁷ Section 29. *“Where in any proceedings a costs order is made in favour of any party who has taken out an insurance policy against the risk of incurring a liability in those proceedings, the costs payable to him may, subject in the case of court proceedings to rules of court, include costs in respect of the premium of the policy.”*

⁶⁸ Section 58A(6) of the Courts and Legal Services Act 1990, as substituted by section 27 of the Access to Justice Act 1999, provides that: *“A costs order made in any proceedings may, subject in the case of court proceedings to rules of court, include provision requiring the payment of any fees payable under a conditional fee agreement which provides for a success fee.”*

now, because they cannot rely on the prospect of recovering damages to meet the cost of the uplift and premium;

- *discourage weak cases and encourage settlements; and*
- *provide a mechanism for regulating the uplifts that solicitors charge – in future unsuccessful litigants will be able to challenge unreasonably high uplifts when the court comes to assess costs.*⁶⁹

3.36 In one sense, the changes concerning the recoverability of the insurance premium and the success fee simply strengthened the ordinary costs rule that costs follow the event and the loser should pay. In another sense, they could be seen as asking the loser to pay twice.⁷⁰ They have certainly been the source of much controversy and satellite litigation.

3.37 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),⁷¹ which will be discussed further in Chapter 4, Lord Nicholls of Birkenhead gave his views as follows:

“... The underlying problem, it was said, is that claimants now operate in a costs-free and risk-free zone.

... By entering into a conditional fee agreement at the outset, a claimant achieves the position that his solicitor's charges will never be payable by him or at his expense. If his claim is successful the fees, including the amount of the uplift, will be payable by the defendant's liability insurers. If his claim is unsuccessful, nothing will be due from him to his solicitor under the agreement. Likewise with the premium payable for after the event insurance: if the claim is successful, the premium will be payable by the other side's liability insurers. If the claim is unsuccessful, nothing will be payable by the claimant when, as frequently happens, the policy provides that no premium will be payable in that event.

The consequence, it was said, of these arrangements, hugely attractive to claimants, is that claimants are entering into conditional fee agreements, and after the event insurance, at an inappropriately early stage. They have every incentive to do so, and no financial interest in doing otherwise. Moreover, in entering into conditional fee agreements and insurance arrangements they have no financial interest in keeping down

⁶⁹ Para 3.2.

⁷⁰ Richard Moorhead, *Conditional Fee Agreements, Legal Aid and Access to Justice*, University of British Columbia <<http://flair.law.ubc.ca/ilac/Papers/15%20Moorhead.html>>.

⁷¹ [2002] UKHL 28, 2000.

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."⁷²

3.38 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."*⁷³

3.39 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.⁷⁴

The Conditional Fee Agreements Regulations 2000

3.40 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.

General requirements

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

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

⁷² At 2005 – 2006.

⁷³ At 2004.

⁷⁴ (2002), 52 De Paul L Rev 259, at 5.

in particular, whether the amounts are limited by reference to the damages which may be recovered on behalf of the client.

Conditional fee agreements with a success fee

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

- “• *the [agreement] must provide that where the success fee is payable (i.e. there is a win as defined in the agreement) then –*
 - *if the success fees are assessed and the legal representative or the client is required by the court to disclose the reasons for setting the success fee percentage at the level stated in the [agreement], he may do so;*
 - *if the success fee is assessed and any amount of it is disallowed on the ground that the level at which the success fee or percentage was set was unreasonable in view of the facts which were or should have been known to the legal representative at the time it was set, then the amount disallowed ceases to be payable under the agreement unless the court is satisfied that it should continue to be so payable; and*
 - *if there is no assessment of the success fee but the parties agree a settlement of costs under which a lower success fee is agreed to be paid, the amount payable under the [agreement] in respect of the success fee shall be reduced accordingly unless the court is satisfied that the full amount should continue to be payable.”⁷⁵*

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

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

⁷⁵

Greenslade on Costs, at G-032.

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

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

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

3.44 Problems emerged from the uncertainties and satellite litigation concerning the enforceability of conditional fee agreements and the recoverability of the ATE insurance premium and success fee.⁷⁶ A losing defendant has, on many occasions, been able to overturn a conditional fee agreement on the basis that some technicality has not been complied with. This has triggered further reforms.

Collective Conditional Fee Agreements Regulations 2000

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

⁷⁶

This is discussed, below, at Chapter 4.

3.46 The Lord Chancellor's Department issued a Consultation Paper on *Collective Conditional Fees* in June 2000 which resulted in the promulgation of the Collective Conditional Fee Agreements Regulations 2000.⁷⁷ Many features of the Collective Conditional Fee Agreements Regulations 2000 mirror the requirements for individual conditional fee agreements, and the main provisions are as follows:

- A collective conditional fee agreement is defined as an agreement which provides common terms for pursuing cases under the agreement, but which specifies individual success fees for those cases.
- There would be no prescription as to who could provide or use a collective conditional fee agreement, so that the public has a range of service providers to choose from.
- Where a success fee is contracted for, a separate risk assessment will be drawn up for each individual case. This must be made available to the court where costs were challenged.
- The collective agreement should contain terms that:
 - specify the conditions under which the legal representatives' fees are payable;
 - provide for the disclosure to the court of the document setting out the reasons for setting the success fee at a given level;
 - provide that any amount of the success fee disallowed on assessment as being unreasonable would cease to be payable under the agreement, unless the court orders otherwise;
 - specify that the legal representative cannot agree with the opponent to settle for a lower success fee and then seek to recover the difference from his client, unless the court orders otherwise.

3.47 In *Stanley Thornley v Patrick Lang*,⁷⁸ a collective conditional fee agreement between a bus drivers' union and its solicitors was challenged by the defendants, who admitted liability but objected to paying the 20% success fee agreed between the union and its solicitors. The Court of Appeal upheld the finding that the costs payable by the defendant to the claimant should include the 20% success fee.

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

3.48 These rules, amongst other things, introduce a scheme of fixed

⁷⁷ SI 2000/2988.

⁷⁸ [2003] EWCA Civ 1484.

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

3.49 The amount of agreed damages is calculated after taking account of contributory negligence. If the case is financed by a conditional fee agreement with a success fee, the success fee is recoverable though the rate of the success fee was not fixed under the scheme. The Civil Justice Council conducted costs mediation with relevant bodies, and there is now an industry-wide agreement that an appropriate success fee for RTA cases that settle pre-trial is 12.5% of base costs. The figure for those won at trial is 100%. Currently in personal injury cases, fixed success fees only apply to employer's liability accident cases and RTA cases worth less than £15,000 that occurred after 5 October 2003. Work is under way to extend fixed success fees to disease and public liability claims run under conditional fee agreements.⁷⁹

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

3.51 In exceptional circumstances, "*the court will entertain a claim for an amount of costs ... greater than the fixed costs.*"⁸⁰ The rules and practice directions are, however, silent as to what constitutes exceptional circumstances. Even if a claimant establishes that there are exceptional circumstances, but on assessment fails to obtain an award which is at least 20% more than the amount of the fixed costs, costs penalties will apply.⁸¹

3.52 According to Peysner,⁸² the fixed costs scheme is susceptible to legal challenge. Originally, it was envisaged that the fixed costs scheme would be introduced together with the abolition of the costs indemnity rule. This has not materialised and, in principle, the claimant's solicitors can claim only reasonable costs. If the fixed costs are higher than reasonable costs, the difference should belong to the claimant. The "exceptional circumstances" provision discussed in the previous paragraph is only available to the claimant's solicitor who believes his entitlement is higher than the fixed costs, and there is no equivalent provision available to the payer who believes that the fixed costs are too high.

⁷⁹ UK Dept for Constitutional Affairs, *Conditional Fees in context – Notes on the English experience*, Sept 2004.

⁸⁰ Rule 45.12.

⁸¹ Rule 45.13.

⁸² John Peysner, Fixing costs: settled RTA cases, NLJ 31 October 2003 at 1640-1.

Conditional Fee Agreements (Miscellaneous Amendments) Regulations 2003

3.53 These Regulations introduced a simplified version of conditional fee agreement which is often referred to as “simple CFA” or “CFA lite” and came into force on 2 June 2003. It should be noted that the provisions relating to the giving of information prior to entering into conditional fee agreements do not apply to simple CFAs. Apart from simplifying the requirements in certain types of conditional fee agreements, solicitors will be able to agree lawfully with their clients not to seek to recover by way of costs anything in excess of what the court awards, or what is agreed will be paid, and will no longer be prevented from openly contracting with their clients on such terms.⁸³ The indemnity principle is therefore modified to some extent. Similar consequential amendments have been made to the Collective Conditional Fee Agreements Regulations 2000.

3.54 A substantial part of the detailed consumer protection provisions were removed from the Regulations. Clients still enjoy protection under the Solicitors’ Professional Rules of Practice which forbid overcharging.⁸⁴ The Rules of Practice are designed to ensure that clients are given the information they need in order to understand what is happening, and in particular are informed of the cost of legal services at the outset and as the case progresses. The changes were a response to a number of cases in which the losing defendant had successfully challenged the conditional fee arrangement on taxation where some small detail of the regulations had not been followed precisely. The effect was that the fee arrangement was void, meaning the defendant escaped paying costs and the plaintiff’s solicitor was unable to recover costs from his client.

3.55 “CFA lite” still requires the agreement to specify:⁸⁵

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

DCA Consultation Paper June 2003

3.56 In June 2003, the Department for Constitutional Affairs issued a consultation paper entitled *Simplifying CFAs* which looked at the detailed requirements in the Conditional Fee Agreements Regulations 2000, the Collective Conditional Fee Agreements Regulations 2000 and the Membership

⁸³ Explanatory Note to the Regulations.

⁸⁴ Section G.

⁸⁵ Regulation 3A(4).

Organisation Regulations 2000 to see whether they were still appropriate in view of the developments in case law and the legal services market. Given concerns that the secondary legislation was too complicated and did not reflect the actual needs of consumers, the consultation paper aimed to promote discussion on whether and how the secondary legislation could be simplified.

Conditional Fee Agreements Forum 2003

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

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

DCA Consultation Paper June 2004

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

(1) Simplifying the regulations

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

The DCA believes that the process of simplification, which started with the introduction of “CFA lite” in June 2003, should be continued. The DCA therefore proposes to revoke the 2000 Regulations and replace them with one set of regulations covering collective conditional fee agreements as well. The DCA also proposes to remove as far as possible the detailed

client care and costs information requirements from the 2000 Regulations, and to leave these areas to be regulated by the professional bodies' conduct rules.

(2) Recoverability⁸⁶

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

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

To assess, amongst other issues, the impact of recoverable success fees and ATE insurance premiums on the outcome of personal injury claims, the DCA commissioned a comprehensive study by Professor Paul Fenn, Professor Neil Rickman and Professor Alistair Gray. The report⁸⁷ was published in February 2006. The report contains numerous findings and included the following:

- In the previous study before recoverability of success fees and ATE insurance premiums was introduced, it was found that in 80% of all claims run on a conditional fee basis, there was no or no significant dispute over liability. After recoverability, the equivalent figure was 78%, and the difference was not statistically significant.⁸⁸
- Conditional fee agreements have become the predominant means of finance for personal injury claims. For cases opened between October 2002 and September 2003, 93% of accident management companies cases, 99% of trade union cases, 91% of Before-the-Event (BTE) insurance cases, and 86% of "other categories" cases were conducted on a conditional fee basis.

⁸⁶ This refers to the provisions in the Access to Justice Act 1999 enabling the successful litigant to recover from the losing litigant the ATE insurance premium incurred and the success fee (agreed between the successful litigant and his own lawyer - but subject to taxing by the court).

⁸⁷ Entitled "The funding of personal injury litigation: comparisons over time and across jurisdictions".

⁸⁸ Note however that after recoverability was introduced, a substantial amount of satellite litigation was costs-only proceedings in which liability was not an issue.

- It was found that cases run under collective conditional fee agreements had significantly lower base costs than (non-conditional) BTE cases. By contrast, conditional fee agreement cases had significantly higher total costs than BTE cases – presumably as a consequence of success fees and ATE insurance premiums.

(3) Defamation cases

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

- Conditional fees inhibit media organisations from running a legitimate defence and provide defamation claimants with an unfair advantage. The financial impact inhibits the activities of media organisations and breaches their right to a fair trial. This is the so-called “ransom effect”.
- Conditional fees encourage/enable claimants with weak cases to litigate. Solicitors take on hopeless cases on a speculative basis, contrary to the principal aims of the conditional fees regime which are: to improve access for those with meritorious claims, to discourage weak claims and to enable successful claimants to recover reasonable costs.
- Success fees produce excessive costs (when combined with already relatively high hourly rates) and there is an insufficiently competitive market to control lawyers’ fees. Lawyers enter into conditional fee agreements with 100% success fees even for the most straightforward cases, and the odds in defamation cases are stacked against the defendant where the claimant has a conditional fee agreement and no ATE insurance. Conditional fees therefore inhibit freedom of expression and curb investigative reporting. Editors may become risk-averse. This is the so-called “chilling effect”.
- Conditional fees encourage litigation rather than alternative dispute resolution such as provided by the Press Complaints Commission.
- Conditional fees are being used by rich claimants who could afford to pay conventional legal fees.

The DCA referred to the decision of the Court of Appeal in *Adam Musa King v Telegraph Limited*,⁸⁹ which concerns a defamation action brought under a conditional fee agreement without any ATE insurance cover. The Court of Appeal has set out some findings and guidance, of which extracts are reproduced below:

- *“... As a general rule, Parliament has decided that it is appropriate to order a party opposed to one funded by a CFA to pay costs at a level that would not ordinarily be regarded as reasonable or proportionate. Defamation proceedings, however, represent a potential infringement of the right to freedom of expression guaranteed by ECHR Article 10(1), and a particularly sensitive approach is required to costs issues.” [para 96]*
- *“What is in issue in this case, however, is the appropriateness of arrangements whereby a defendant publisher will be required to pay up to twice the reasonable and proportionate costs of the claimant if he loses or concedes liability, and will almost certainly have to bear his own costs (estimated in this case to be about £400,000) if he wins. The obvious unfairness of such a system is bound to have the chilling effect on a newspaper exercising its right to freedom of expression ... and to lead to the danger of self imposed restraints on publication which he so much feared.” [para 99]*
- *“It cannot be just to submit defendants in these cases, where their right to freedom of expression is at stake, to a costs regime where the costs they will have to pay if they lose are neither reasonable nor proportionate and they have no reasonable prospect of recovering their reasonable and proportionate costs if they win.” [para 101]*
- *“There are three main weapons available to a party who is concerned about extravagant conduct by the other side, or the risk of such extravagance. The first is a prospective costs capping order of the type I have discussed in this judgment. The second is a retrospective assessment of costs conducted toughly in accordance with CPR principles. The third is a wasted costs order against the other party’s lawyers, but this is not the time or place to discuss the occasions when that would be the appropriate weapon.” [para 105]*

⁸⁹

[2004] EWCA (Civ) 613.

The Law Commission had published a scoping study about the perceived abuses of defamation procedure in May 2002.⁹⁰ A section was devoted to conditional fee agreements and the Commission tentatively suggested that “*the current arrangements*” might constitute an infringement of articles 6 and 10 of the European Convention on Human Rights.

Despite the criticisms launched at the use of conditional fees in defamation cases, the DCA does not propose to legislate to restrict the use of conditional fees in these actions. The DCA believes that conditional fees help ensure that the ability to pursue a defamation claim is no longer just the preserve of the rich. Otherwise, a meritorious case such as *Walker v Newcastle Chronicle and Journal Ltd*,⁹¹ would not have been possible. It supports the vigorous use of the existing case management and costs control powers in the Civil Procedure Rules to ensure reasonable and proportionate behaviour and costs on both sides.

(4) *Pro bono* cases

Prior to 1995, because of the costs indemnity principle, lawyers acting on a *pro bono* basis could not recover any costs from the other side even if they won the case. The introduction of conditional fees has had a positive impact on the amount of *pro bono* type litigation undertaken: solicitors took on more *pro bono* cases since it was now possible to recover costs from the losing opponent, whilst CFA clients would not have to bear costs if the claim failed. The 2003 amendments created “CFA lite”, a simplified form of conditional fee agreement, and offered a simpler and more suitable vehicle for lawyers acting for clients on a *pro bono* basis to recover reasonable costs from opponents and to pass those costs to the relevant charitable *pro bono* organisation to support *pro bono* work.

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

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

⁹⁰ Aspects of Defamation Procedure – <www.lawcom.gov.uk/files/defamation.pdf>.

⁹¹ November 2000. The “Sunday Sun” and the “Evening Chronicle” published some articles in which it was alleged that the Claimant had pursued a “Fatal Attraction” campaign of revenge against her former lover including the attempted murder of his wife. The Defendant apologised to the Claimant and accepted that none of the allegations were true. The Defendant paid the Claimant damages and her costs.

Civil Justice Council's Report August 2005

3.60 In August 2005, the Civil Justice Council published a report entitled "Improved Access to Justice – Funding Options and Proportionate Costs" ("the CJC Report"). The CJC Report is the result of a review of the problems relating to the funding of civil claims and proportionality of costs. The trigger for the review was the growth of satellite litigation⁹² largely spawned by technical issues concerning conditional fee agreements.

3.61 The CJC Report made a total of 21 recommendations. A number of the recommendations are practical proposals directed at small value personal injury road traffic accidents. Some of the report's recommendations are of particular interest to our review. These are:

Recommendation 10

"With a view to increasing access to justice and providing funding options in cases where ATE insurance is unavailable, the Legal Services Commission should give further consideration to the Conditional Legal Aid scheme (CLAS) previously proposed by the Law Society, the contingency Legal Aid Fund (CLAF) previously proposed by the Bar Council and JUSTICE, and the Supplementary Legal Aid System (SLAS) operating in Hong Kong."

Recommendation 11

"In contentious business cases where contingency fees are currently disallowed, American style contingency fees requiring abolition of the fee shifting rule should not be introduced." "However, consideration should be given to the introduction of contingency fees on a regulated basis along similar lines to those permitted in Ontario by the Solicitors' Act 2002 particularly to assist access to justice in group actions and other complex cases where no other method of funding is available."

Recommendation 13

"Building on the judgment of the Court of Appeal in „Arkin“ further consideration should be given to the use of third party funding as a last resort means of providing access to justice."

Recommendation 14

"Encouragement should be given to the further expansion and public awareness of Before the Event Insurance to provide wider

⁹² *Callery v Gray* (No 1) [2001] EWCA Civ 1117; *Callery v Gray* (No 2) [2001] EWCA Civ 1246; *Callery v Gray* (Nos 1 & 2) [2002] UKHL 28; *Sarwar v Alam* [2001] EWCA Civ 1401; *Claims Direct Test Cases* [2003] EWCA Civ 136; *The Accident Group* [2004] EWCA Civ 575; *Hollins v Russell* [2003] EWCA Civ 718.

affordable access to justice funding complemented where necessary by a strong After the Event Insurance market.”

Recommendation 18

“The CJC endorses the proposed legislation announced by the Government to regulate Claims Management Companies and urges that this be introduced with as much speed and rigour as possible so as to protect consumers and reduce if not remove opportunities for „technical“ costs litigation that have bedevilled the Courts at all levels.”

Recommendation 19

“Successful litigants in person should be entitled to a simple flat rate (or fixed fee in a scale scheme) whether or not they have sustained financial loss.”

Recommendation 21

“That the DCA and the professional bodies (Law Society and Bar Council) should work together with the Attorney General’s pro bono co-coordinating committee to introduce a pro bono CFA.”

Repeal of the Conditional Fee Agreements Regulations

3.62 In August 2005, the Department of Constitutional Affairs announced that, with effect from 1 November 2005, the Conditional Fee Agreements Regulations 2000, the Collective Conditional Fee Agreements Regulations 2000, and the Conditional Fee Agreements (Miscellaneous Amendments) Regulations 2003 would be repealed. The purpose of the change is to simplify the conditional fee regime. Conditional fee agreements now have to comply with section 58 of the Courts and Legal Services Act 1990 (as amended by section 27 of the Access to Justice Act 1999). Agreements must still be in writing, and must not relate to criminal or family proceedings, and in the case of a success fee, the percentage increase must be specified and must not exceed the current limit of 100%.

3.63 The primary responsibility for client care, contractual and guidance matters will be governed by the Law Society’s Solicitors’ Costs Information and Client Care Code 1999. It was envisaged that by moving the detailed requirements of the regulations to the Law Society’s Costs Information Code, it would be less likely that minor failures to comply would result in disproportionate sanctions.

3.64 The Law Society’s Costs Information Code has for the most part repeated the existing regulations as to the information which must be given to clients. The only amendments which became effective on 1 November 2005 provide that the solicitor should explain:

- the circumstances in which the client may be liable for his own costs and for the other party's costs;
- the client's right to assessment of costs, wherever the solicitor intends to seek payment of any or all of his costs from the client; and
- any interest a solicitor may have in recommending a particular policy or other funding.⁹³

3.65 It remains to be seen whether the abolition of the 2000 and 2003 Regulations can reduce the amount of technical challenges to conditional fee agreements. The decisions of *Awwad v Geraghty & Co (A Firm)*⁹⁴ and *Garbutt v Edwards*,⁹⁵ which will be discussed together with other cases in the next chapter, will shed some light on the issue.

The use of conditional fee agreements in England

3.66 Conditional fee agreements have been used primarily and extensively for personal injury litigation and it appears that a greater number of injured parties are making claims. It might therefore be said that the objective of increasing access to justice has been achieved. There are, however, a number of inter-related factors which are difficult to separate:

- The substantial cutback in the availability of legal aid has inevitably forced more potential claimants to make use of conditional fee agreements.
- Conditional fee agreements have reshaped the whole claims industry and extensive advertisements are now made by claims management companies and by some personal injury lawyers. This has raised awareness that claims are possible, and has led to more claims being brought.
- For the middle-income claimant who is not wealthy but is not eligible for legal aid, making a claim is now a possibility, and he can bring a claim with no costs liability at all. The fact that a claimant can now litigate without financial exposure is balanced by the fact that only cases with a reasonable prospect of success will be taken on by lawyers on a conditional fee basis.
- The reforms of the conditional fee regime in 2000 coincided with the extensive shake-up of civil procedure, and it is not always

⁹³ See decision of *Deborah Garrett v Halton Borough Council* (Liverpool County Court, unreported 5 April 2005). It was held that firms must declare their interest to clients in recommending an ATE insurance policy.

⁹⁴ [2001] QB 570.

⁹⁵ [2005] EWCA Civ 1206.

easy to separate the effect of pre-action protocols and procedural reforms from the effect of conditional fee arrangements.

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

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

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

3.70 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.

3.71 However, there has been a spate of satellite litigation involving technical challenges to the validity and legality of conditional fee agreements. This chapter has set out the successive changes in legislation and rules which have taken place in England in recent years. The common law, as we shall see in the next chapter, has also been developing rapidly.

Chapter 4

Problems and litigation in England

Introduction

4.1 As can be seen from the previous chapter, the funding regime for civil litigation involving the use of conditional fees and ATE insurance is still developing and it seems that further changes can be expected to deal with the various problems surrounding the conditional fee regime, especially that of satellite litigation. Satellite litigation has raised issues such as the reasonableness and recoverability of success fees and insurance premiums, problems posed by the costs indemnity rule and the position of other forms of outcome-related fees at common law, the legality of conditional fee agreements, and the proportionality of costs. These will each be examined in turn in this chapter.

Litigation on the recoverability of success fees and insurance premiums

Callery v Gray

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

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

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

4.4 Amelans submitted a bill for £4,709.35 as legal costs and £350 for the ATE insurance premium. The parties were unable to agree on what constituted reasonable costs. The parties accordingly commenced costs-only proceedings pursuant to Civil Procedure Rules, rule 44.12A. The judge ruled that a success fee of 40% (instead of 60%) was reasonable and that both the success fee and the insurance premium were recoverable in costs-only proceedings.

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

4.6 The Court of Appeal² identified three main issues on the appeals: first, whether an ATE premium could be recovered in costs-only proceedings under rule 44.12A of the Civil Procedure Rules ("the jurisdiction issue"); second, the stage of a dispute at which it was appropriate to enter into (a) a conditional fee agreement and (b) an ATE policy ("the prematurity issue"); and third, the reasonableness of the claimant's (a) success fee and (b) ATE premium ("the reasonableness issue").

The jurisdiction issue

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

The prematurity issue

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

² [2001] 1 WLR 2112.

might fail. The defendant maintained that the appropriate time to obtain ATE insurance was at the end of the protocol period, (ie three months from the notification of the claim). The defendant pointed out that since over 90% of cases could be expected to settle (and might well settle) in the protocol period, the defendant should be given a fair chance to settle the case without incurring liability for additional costs.³

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

Court of Appeal decision

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

Government policy

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

Policy and practical considerations

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

- “(i) If the new regime is to achieve its object, the legal costs of claimants whose claims fail should fall to be borne by unsuccessful defendants On these appeals the court has to decide whether to permit liability for success fees to be apportioned in relatively small amounts among many unsuccessful defendants, or to insist on an approach*

³ Paras 87-89, 98.

⁴ Para 90.

⁵ Paras 99-100.

⁶ Para 92.

⁷ Para 95.

under which they will be borne in much larger amounts by those unsuccessful defendants who persist in contesting liability.

- (ii) If the latter alternative is adopted, the defendants who contest liability will not share liability for costs in a manner which is equitable. Where there is a strong defence which it is reasonable to advance, a larger uplift will be appropriate than where a defendant unreasonably persists in contesting liability despite the fact that the defence is weak. Thus the more reasonable the conduct of the defendant, the larger the uplift that he will have to pay if his defence fails.*
- (iii) In relation to claims arising out of road accidents, where defendants will be insured, the same insurers will often be sharing the costs involved, whether in the form of many uniform small uplifts or fewer large uplifts.*
- (iv) So far as insurance premiums are concerned, these will produce cover which benefits the defendants, for they will ensure that costs are awarded against unsuccessful claimants and that such awards are satisfied.*
- (v) Defendant interests, with the assistance of the court, should be able to restrict uplifts and insurance premiums to amounts which are reasonable having regard to overall requirements of the scheme. In saying this we are contemplating a position where there will be adequate data to enable informed judgment of the amount of uplift and the size of insurance premiums that are reasonable in circumstances such as those before the court. We are well aware that that position has not yet been reached and that, on these appeals, we are faced with doing our best on very sketchy data. We have had particular regard to the fact that the representations and evidence submitted after the hearing have not been tested or analysed in the course of oral argument.*
- (vi) Claimants naturally want to know at the outset that a satisfactory arrangement to cover the costs of litigation has been made which provides sufficient protection for them, no matter what the outcome.*
- (vii) Claimants incur liabilities for costs to their legal advisers as soon as they give them instructions. Once a defendant starts to incur costs in complying with a protocol, the claimant will be exposed to liability for those costs if proceedings are commenced.*

- (viii) *Solicitors and claims managers are anxious to be able to offer legal services on terms that the claimant will not be required to pay costs in any circumstances. This will assist access to justice.*
- (ix) *There is the overwhelming evidence from those engaged in the provision of ATE insurance that unless the policy is taken out before it is known whether a defendant is going to contest liability, the premium is going to rise substantially. Indeed the evidence suggests that cover may not be available in such circumstances.*⁸

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

The House of Lords decision

4.14 Dissatisfied with the Court of Appeal's decision, the defendant took the case before the House of Lords, whose decision was delivered in June 2002.⁹ The House of Lords declined to interfere with the Court of Appeal's ruling because it was pre-eminently the responsibility of the Court of Appeal, not the House of Lords, to supervise the developing practice of funding litigation by conditional fee agreements and ATE insurance. Since the House of Lords could not respond to changes in practice with the speed and sensitivity of the Court of Appeal, it should in general be slow to intervene in such a case, especially given the early stage in the practical development of the new regime, the sparsity of reliable factual material, the meagre experience of the market, the difficulty of discerning trends and the provisional nature of the Court of Appeal's guidance to be reviewed in the light of increased knowledge and experience. It may be useful to set out some of the observations made by the House of Lords.

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

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

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

⁸ Para 99.

⁹ [2002] 1 WLR 2000.

¹⁰ Para 107 at 2026.

¹¹ Para 108 at 2026.

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

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

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

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

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

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

4.19 Zander in his article¹⁷ examined the case and pointed out that Lord Scott had a powerful argument. He also pointed out that in the subsequent Claims Direct Test Cases¹⁸ Lord Scott's dissenting view on the prematurity issue seemed to have been followed by Chief Costs Judge Master Hurst who said *obiter* that:

¹² Para 111 at 2027.

¹³ Para 113 at 2028.

¹⁴ Para 114 at 2028.

¹⁵ Para 118 at 2029.

¹⁶ As above.

¹⁷ "Where are we now on Conditional Fees? – or why this Emperor is Wearing Few, if any, Clothes", Modern Law Review – Vol 56, No 6, Nov 2002.

¹⁸ [2001] EWCA Civ 428, [2002] All ER (D) 76 (Sep), accessible on <www.courtservice.gov.uk>.

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

Master Hurst, however, did not give reasons for apparently rejecting the “macroeconomic” considerations about the ATE insurance market in favour of Lord Scott’s views. Therefore, Zander believed it was difficult to be certain as to the significance of Master Hurst’s dictum and, until doubts were clarified by the higher courts, there would be continuing uncertainty. Another author²⁰ commented that Master Hurst’s *obiter* opinion was subsidiary to *Callery*, especially since no evidence on the issue was heard.

Reasonableness of the success fee

Court of Appeal decision

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

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

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

¹⁹ Para 231.

²⁰ Mark Harvey, “*Guide to Conditional Fee Agreements*”, Jordans at 134.

²¹ Para 101.

²² Para 102.

Two-stage success fee

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

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

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

The House of Lords decision

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

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

²³ Para 111.

²⁴ Para 112.

²⁵ Para 7 at 2004.

²⁶ Para 9 at 2005.

²⁷ See paras 12-16 at 2006. See also para 3.50 above.

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

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

“ ... The traditional function of the costs judge, or taxing master, as he used to be called, was to decide what fees were reasonable by reference to his experience of the general level of fees being charged for comparable work. But this approach only makes sense if the general level of fees is itself directly or indirectly determined by market forces. Otherwise the exercise becomes circular and costs judges will be deciding what is reasonable according to general levels which costs judges themselves have determined. In such circumstances there is no restraint upon a ratchet effect whereby the highest success fees obtainable from a costs judge are relied upon in subsequent assessments.

The matter becomes even more difficult when a solicitor „carrying on litigation business on a large scale“ is entitled, as the Court of Appeal have said, at p 2131, para 83, to fix success fees to ensure „that the uplifts agreed result in a reasonable return overall, having regard to his experience of the work done and the likelihood of success or failure of the particular class of litigation“. The costs judge has simply no way of knowing whether the solicitor is carrying on business on a large enough scale to justify such an approach, still less what level of success fees would give him a „reasonable return overall“. Such matters are traditionally outside the consideration of costs judges.”

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

4.29 Zander commented that:

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

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

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

Reasonableness of the ATE premium

Court of Appeal decision

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

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

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

The House of Lords decision

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

²⁹ New Law Journal 20 September 2002.

³⁰ [2001] 1 WLR 2142.

³¹ Paras 69-70 at 2159.

³² Para 71 at 2159.

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

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

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

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

Comments on Callery v Gray

4.34 Zander has pointed out³⁶ that there was widespread agreement amongst the senior judiciary that the determination of costs was an area in total chaos. Despite that widespread concern, Zander believed that it was not likely that the Lord Chancellor would accept Lord Hoffmann's suggestion that the Government should intervene to regulate success fees and ATE premiums.

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

4.35 This case³⁷ concerned a straightforward traffic accident in which the claimant entered into a Law Society model conditional fee agreement. The success fee was set at 40% of the basic charges, and ATE insurance was taken out at a premium of £840. The claim was settled save for costs, and costs-only proceedings were taken out. The parties subsequently agreed that

³³ At p 2128, para 67.

³⁴ At p 2012-3, para 44.

³⁵ At p 2013, para 44.

³⁶ In his article "Where are we now on Conditional Fees? – or why this Emperor is Wearing Few, if any, Clothes", cited above, at 930.

³⁷ New Law Journal 20 September 2002.

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

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

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

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

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

Comments on Halloran v Delaney

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

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

³⁹ Para 106.

⁴⁰ [2001] 1 WLR 2112 at para 105.

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

4.39 Mark Harvey⁴¹ has suggested that the comments on the rebated 5% success fee should be treated as *obiter*, and not as forming part of the judgment.⁴² He believed that *Halloran* was at best persuasive, and that *Callery* remained good law. He suggested that law firms should resist the imposition of a 5% rebated success fee. The courts would impose such a figure regardless of what was written in the conditional fee agreement if the courts wished to do so. However, he recommended that firms should seriously consider adopting a two-stage success fee, given that *Halloran* added support to the proposal put forward in *Callery*.

4.40 Greenslade⁴³ has observed, however, that *Callery* has not provided the hoped for general guidance and that further developments, perhaps including statutory intervention, can be expected in this field.

The effect of BTE insurance on the recoverability of ATE premiums

***Sarwar v Alam* – 2001**

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

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

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

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

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

⁴³ Greenslade on Costs, at A1-035.

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

⁴⁵ Para 39.

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

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

On the other hand:

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

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

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

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

⁴⁶ Para 41.
⁴⁷ Para 43.

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

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

Sarwar v Alam – 2003

4.48 The case was brought before the court again in 2003⁵⁰ and was heard by a Costs Judge, Master Rogers. The claimant was prepared to settle for £2,250 damages, but the claimant's bill of costs for £255,745.30 was disputed by the defendant. The Costs Judge decided in favour of the defendants that the costs appeared on their face to be disproportionate and the "necessary test" laid down by Lord Woolf LCJ in *Home Office v Lownds*⁵¹ had to be applied. The issues raised at the further hearing included:

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

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

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

⁴⁸ Para 54.

⁴⁹ Para 58.

⁵⁰ [2003] EWHC 9001. Judgment was given on 7 March 2003.

⁵¹ [2002] 2 Costs LR 279.

⁵² [2002] EWHC Civ 1739.

⁵³ Unreported, but available on SCCO page of Court Service website.

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

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

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

Re Claims Direct Test Cases

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

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

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

The position of outcome-related fees at common law and problems with the costs indemnity rule

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

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

British Waterways Board v Norman

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

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

⁵⁵ (1993) 26 HLR 232.

⁵⁶ [1995] 4 All ER 695.

⁵⁷ [1998] QB 781.

⁵⁸ [1998] 3 All ER 238.

⁵⁹ [2000] 3 WLR 1041.

⁶⁰ Legal Aid Act 1988, section 21.

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

The indemnity rule

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

4.59 There was also authority⁶² that the agreement as to costs need not be express. The court considered the nature of the agreement between Mrs Norman and her solicitors and concluded that "*there must have been an understanding between them amounting in law to a contract that they would not look to her for any costs if she lost.*" That was enough for the court to hold that the costs had not been "*properly incurred*" by Mrs Norman and to allow the Board's appeal. The court nevertheless went on to consider the Board's second ground of appeal.

Public policy

4.60 In relation to the Board's argument that the agreement as to costs between Mrs Norman and her solicitors amounted to a contingency fee and was therefore unlawful as contrary to public policy, the Board's lawyers referred to section 59 of the Solicitors Act 1974⁶³ and rule 8.1 of the Solicitors' Practice Rules 1990,⁶⁴ both of which rendered contingency fee arrangements unlawful. In reply, Mrs Norman argued that, in the light of section 58 of the Courts and Legal Services Act 1990,⁶⁵ it could no longer be said that

⁶¹ [1910] 1 KB 645.

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

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

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

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

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

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

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

In 1967 following proposals of the Law Commission, Parliament abolished criminal and civil liabilities for champerty and maintenance but subject to this important reservation in section 14(2) of the Criminal Law Act 1967:

„The abolition of criminal and civil liability under the law of England and Wales for maintenance and champerty shall not affect any rule of that law as to the case in which a contract is to be treated as contrary to public policy or otherwise illegal.“

It was suggested to us that the only reason why „contingency fees“ were not allowed in England was because they offended against the criminal law as to champerty: and that, now the criminal liability is abolished, the courts were free to hold that contingency fees were lawful. I cannot accept this contention. The reason why contingency fees are in general unlawful is that they are contrary to public policy as we understand it in England.”⁶⁸

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

66

At pages 240-241.

67

[1975] QB 373.

68

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

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

"... Modern public policy condemns champerty in a lawyer whenever he seeks to recover – not only his proper costs – but also a portion of the damages for himself: or when he conducts a case on the basis that he is to be paid if he wins but not if he loses. As I said in Re Trepca Mines Ltd (No 2) [1963] Ch 199, 219-220:

„The reason why the common law condemns champerty is because of the abuses to which it may give rise. The common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress evidence or even to suborn witnesses."

This reason is still valid after the Act of 1967."⁷⁰

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

Aratra Potato Co Ltd v Taylor Joynson Garrett⁷²

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

Thai Trading Co v Taylor⁷³

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

⁶⁹ [1980] QB 629.

⁷⁰ At page 654A.

⁷¹ At page 242.

⁷² [1995] 4 All ER 695.

⁷³ [1998] QB 781.

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

4.66 Giving the judgment of the Court of Appeal, Lord Justice Millett overruled *British Waterways Board* and *Aratra Potato Co Ltd* for reasons which can be conveniently divided into four main areas: legislation and rules; differentiating maintenance and champerty; changing public policy; and absence of implied contract as to costs. Lord Justice Millett concluded that there was nothing unlawful in a solicitor acting for a party to litigation agreeing to forgo all or part of his fee if he lost, provided that he did not seek to recover more than his ordinary profit costs and disbursements if he won.

Bevan Ashford v Yeandle Ltd⁷⁴

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

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

⁷⁴ [1998] 3 All ER 238.

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

4.69 Zander has observed⁷⁵ that the common law seemed at that time to have changed after these decisions, and both the Bar Council and the Law Society amended their rules accordingly. The Code of Conduct issued by the General Council of the Bar was amended in July 1998 to the effect that a barrister may charge “*on any basis or by any method he thinks fit provided that such basis or method is (a) permitted by law; and (b) does not involve the payment of a wage or salary.*”⁷⁶ The Guidance to the Code of Conduct explains that the new rule would permit at least the following arrangements: (a) “no win, no fee” (where the barrister agreed to forego the whole of his fee if the case is lost); (b) “no win, reduced fee” (where the barrister forfeits part of his fee if the case is lost); and (c) some conditional fee agreements outside the statutory scheme.⁷⁷

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

4.71 On 1 April 2000, the provisions of the Access to Justice Act 1999 came into force. The Act gives statutory effect to the judgment in *Thai Trading Co v Taylor*, and section 27 permits the recovery of costs under a conditional fee agreement, including one providing for a success fee. Family proceedings and criminal proceedings cannot be the subject of an enforceable conditional fee agreement, but a new section 58A(1)(a) of the Courts and Legal Services Act 1990⁷⁸ specifically allows conditional fee agreements under section 82 of the Environmental Protection Act 1990, so taking account of those in the position of Mrs Norman in the *British Waterways* case.

Cases not following *Thai Trading Co*

*Hughes v Kingston-upon-Hull City Council*⁷⁹

4.72 Even before the major decision of the Court of Appeal in *Awwad v Geraghty & Co* discussed below, some doubts were cast on *Thai Trading Co*. The Divisional Court in *Hughes v Kingston upon Hull City Council* decided that it was not bound by *Thai Trading Co* because the judges in that case had not been referred to the binding authority of the House of Lords in *Swain v Law Society*.⁸⁰ In *Swain*, the House of Lords held that the Law Society’s Practice Rules had the force of law. Hence, the Divisional Court came to the

⁷⁵ Zander, “Will the Revolution in the Funding of Civil Litigation in England Eventually Lead to Contingency Fees?” (2002), 52 De Paul L Rev 259.

⁷⁶ Para 308.

⁷⁷ The relevant Guidance has been fully revised in January 2001 and named the Conditional Fee Guidance.

⁷⁸ Added by section 27 of the Access to Justice Act 1999.

⁷⁹ [1999] QB 1193.

⁸⁰ [1983] 1 AC 598.

conclusion that when Lord Justice Millett stated that *“the fact that a professional rule prohibits a particular practice does not of itself make the practice contrary to law”* he had erred in law. The Divisional Court did not address any of the public policy issues but decided the case solely on the basis of the Practice Rules.⁸¹

Awwad v Geraghty & Co

4.73 The Court of Appeal, in *Awwad v Geraghty & Co*,⁸² has restated the common law condemnation of contingency and conditional fee agreements to fund legal proceedings as being champertous, contrary to the public interest, and, hence, unlawful and unenforceable, unless expressly authorised by statute. The earlier Court of Appeal decision in *Thai Trading Co v Taylor*,⁸³ that there were no longer public policy grounds to prevent lawyers agreeing to work for less than their normal fees in the event that they were unsuccessful, has thus been reversed.

4.74 In *Awwad*, the solicitors agreed in 1993 (before conditional fee agreements were allowed) to act for Mr Awwad in a libel case and entered into an oral contract to act at their usual hourly rate if the proceedings were successful and at a reduced rate if unsuccessful. The proceedings were concluded by Mr Awwad’s acceptance of a payment into court. Mr Awwad declined to pay Geraghty & Co.’s bill on the grounds that the conditional fee agreement was unenforceable. The conditional fee agreement in question did not satisfy the requirements of the applicable rules, namely rules 8 and 18 of the Solicitors’ Practice Rules 1990 made pursuant to section 31 of the Solicitors’ Act 1974. The question, therefore, was whether the agreement was unlawful at common law, or, in other words, whether public policy prohibited the recovery of conditional normal fees.

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

*“I share Lord Scarman’s reluctance to develop the common law at a time when Parliament was in the process of addressing those very problems. It is clear from the careful formulation of the statutes and regulations that Parliament did not wish to abandon regulation altogether and wished to move forward gradually. I see no reason to suppose that Parliament foresaw significant parallel judicial developments of the law.”*⁸⁴

4.76 Lord Justice May concurred and added:

“... In so far as public policy might enter the present debate, I agree with Schiemann LJ’s conclusion. ... In my judgment, where Parliament has, by what are now (with section 27 of the

⁸¹ The decision was later applied in *Leeds City Council v Carr The Times*, 12 November 1999.

⁸² [2000] 3 WLR 1041, [2000] 1 All ER 608.

⁸³ [1998] QB 781.

⁸⁴ At 1061.

*Access to Justice Act 1999) successive enactments, modified the law by which any arrangement to receive a contingency fee was impermissible, there is no present room for the court, by an application of what is perceived to be public policy, to go beyond that which Parliament has provided. ...*⁸⁵

4.77 Permission to appeal to the House of Lords was given, but in the event no appeal was taken. The present position is, therefore, that in contentious proceedings no contingency fee arrangement is permissible at all, and no conditional fee arrangement is permissible, even if there is no success fee, unless it complies with the relevant primary and secondary legislation.⁸⁶ Fees are not recoverable under any non-compliant agreement, and any claim for payment based on *quantum meruit* would fail if a court refuses to enforce an agreement for reasons of public policy.

Significance of *Awwad* after 1 November 2005

4.78 As discussed in the previous chapter, the relevant conditional fee regulations⁸⁷ were repealed on 1 November 2005, and the client protection provisions were moved to the Solicitors' Practice Rules. *Awwad* concerned the breach of rules 8 and 18 of the Solicitors' Practice Rules. May LJ in *Awwad* pointed out that since the Rules were made under section 31 of the Solicitors' Act 1974 by the Council of the Law Society with the concurrence of the Master of the Rolls, they were secondary legislation having the force of statute.⁸⁸ May LJ went on to say that, although no doubt not every trifling breach of the Solicitors' Practice Rules would render a relevant transaction unenforceable, in his view, an arrangement to receive a contingency fee contrary to rule 8(1) would make the fee agreement unenforceable.

4.79 The Court of Appeal also considered the effect of a breach of the Solicitors' Practice Rules in the case of *Garbutt v Edwards*⁸⁹. This case will be discussed later in this chapter in the post *Hollins v Russell* section.

Claims intermediaries

English v Clipson

4.80 The decision of the County Court in *English v Clipson*⁹⁰ in August 2002 has serious implications for claims intermediaries, which have been operating conditional fee agreements on a "mass production" scale for a number of years. The County Court ruled that the conditional fee agreements

⁸⁵ At 1068.

⁸⁶ Bar Council, Conditional Fees Guidance, at 10.

⁸⁷ Conditional Fee Agreements Regulations 2000, Collective Conditional Fee Agreements Regulations 2000, Conditional Fee Agreements (Miscellaneous Amendments) Regulations 2003.

⁸⁸ As decided in *Swain v The Law Society* [1983] 1 AC 598.

⁸⁹ [2005] EWCA Civ 1206.

⁹⁰ Claim No: PE 104264.

used by TAG ("The Accident Group") were unenforceable and the insurance premiums irrecoverable. An appeal was originally scheduled to be heard at the end of October 2002 but it now appears that the appeal has not been proceeded with.

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

4.82 In a number of respects, however, defendants' liability insurers, who more often than not pick up the costs bill of the successful claimant, have become concerned at the level of certain elements of those costs, particularly in relatively low value claims. They contend that the costs payable are disproportionate to the amount of damages and that these costs reflect ancillary services provided by the claims management company which have no, or only passing, relevance to the litigation. Elements of those costs which have caused concern and, of late, have been the subject of judicial scrutiny, both as to enforceability and amount, are the success fee and the ATE premium, as in *Callery v Gray* which has been discussed earlier in this chapter.

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

- (1) The potential claimant completes a TAG application form (detailing the circumstances of the accident, the third party, injuries, etc), and a service agreement/declaration form. This document contains what appears to be a detailed explanation of the scheme and appears also to constitute a proposal for the ATE insurance policy.
- (2) If the claim is accepted, a confirmation letter is sent to the claimant. It is at this point that he becomes an insured under the block Legal Protection policy, subject always to later payment of the premium.
- (3) The case is then passed to TAG's associated company, Accident Investigations Limited (AIL), whereupon an AIL employee will contact the claimant to complete a detailed questionnaire. AIL then returns the file to TAG with its recommendations on both liability and quantum.

- (4) If the case has TAG's continued support, the complete file is then passed to their vetting solicitors, Rowe and Cohen, whose task it is to assess whether the case has a better than 50% chance of success and a potential value exceeding £1,500.
- (5) If Rowe and Cohen "approve" the claim, they will then send the case / file to a firm of panel solicitors. That firm has the ensuing 48 hours in which to accept or reject the referral. If they accept, this is subject always to the claimant's formal instructions as client of that firm.
- (6) If the panel solicitor accepts the referral, he must then send to the claimant a conditional fee agreement and a client care letter, which fulfils the requirements of rule 15 of the Solicitors' Practice Rules. In fact, the conditional fee agreement is constituted by reading together the client care letter and its attached written "terms and conditions". At the same time, the panel solicitor sends a copy of those documents to TAG. The conditional fee agreement is concluded between the solicitor and the claimant / client by the latter returning, in due course, to the former a signed copy of the client care letter, although this part of the procedure seems to conflict with what immediately follows.
- (7) TAG then instructs AIL to have one of its employees contact the claimant and arrange a home visit. The AIL employee's task is to (a) explain the conditional fee agreement to the claimant, (b) obtain the claimant's signature on a document entitled "Fact Find and Oral Advice Sheet", and (c) explain to him, and obtain his signature on, the finance agreement by which the claimant borrows the ATE policy premium from the nominated finance provider.

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

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

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

4.85 This case⁹¹ concerned a firm of chartered accountants, Grant

⁹¹ [2002] 3 WLR 1104.

Thornton, which agreed to provide services ancillary to litigation in return for 8% of the final settlement received.⁹² On a preliminary issue as to the claimants' entitlement to costs, the Master held that Grant Thornton's contingency fee agreements were not champertous and the claimants could recover the 8% from the Secretary of State.

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

4.87 The Court of Appeal held that section 58 of the Courts and Legal Services Act 1990, both in its original form and as subsequently amended by the Access to Justice Act 1999, applied only to agreements for the provision of litigation or advocacy services, and did not apply to contingency fee agreements such as those entered into by Grant Thornton, or by expert witnesses for the provision of services ancillary to litigation. The court therefore had to look at the facts of the particular case and consider whether those facts suggested that the agreement in question might tempt the allegedly champertous maintainer for his personal gain to inflate the damages, to suppress evidence, to suborn witnesses or otherwise to undermine the ends of justice.⁹³ In other words, the court had to ask whether the agreement tended to conflict with existing public policy directed to protecting the due administration of justice with particular regard to the interests of the defendant.⁹⁴ The court also added that the legislation had evidenced a radical shift in the attitude of public policy, and conditional fees had been permitted in order to give effect to another facet of public policy – the desirability of access to justice.⁹⁵

Hollins v Russell

4.88 The Court of Appeal decision in *Hollins v Russell*⁹⁶ contains the rulings in six test cases, namely *Sharratt v London Central Bus Co Ltd and other appeals (The Accident Group Test Cases)*, *Hollins v Russell*, *Tichband v Hurdman*, *Dunn v Ward*, *Pratt v Bull*, and *Worth v McKenna*. The appeals raised three distinct issues:

⁹² The agreement was a contingency fee, not a conditional fee, agreement as defined in the Preface of this paper.

⁹³ At para 36.

⁹⁴ At para 44.

⁹⁵ At para 62.

⁹⁶ [2003] EWCA Civ 718, [2003] 4 All ER 590.

- (i) the circumstances in which a receiving party must either disclose its conditional fee agreement to the paying party or endeavour to prove its claim by other means – *Pratt v Bull*, *Worth v McKenna*;
- (ii) whether any costs and disbursements are recoverable from a paying party in the event of non-compliance with the Conditional Fee Agreements Regulations 2000 – all six cases;
- (iii) whether, on the particular facts, the requirements in the Conditional Fee Agreements Regulations 2000 were complied with – *Hollins v Russell* (regulation 2), *Tichband v Hurdman* (regulations 2 and 3), *Pratt v Bull*, *Dunn v Ward* and *The Accident Group Test Cases* (regulation 4).

4.89 The Court of Appeal held that a conditional fee agreement would only be unenforceable due to a breach of the conditions applicable to it under section 58 of the Courts and Legal Services Act 1990 where there had been a material adverse effect either on the protection afforded to the client, or on the proper administration of justice. The court said further that “*the law does not care about very little things*” and a conditional fee agreement should only be declared unenforceable if the breach mattered and the client could have relied upon it against his solicitor.

4.90 Whilst this is a valiant attempt to stop the satellite litigation where a losing defendant challenges the fine details of a conditional fee agreement in an attempt to avoid liability for costs altogether, it creates its own unfortunate uncertainty as to which requirements of the conditional fee regulations are “*very little things*” and which are not.

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

“So far as matters of procedure are concerned, we consider that it should become normal practice for a CFA to be disclosed for the purpose of costs proceedings in which a success fee is claimed. If the CFA contains confidential information relating to other proceedings, it may be suitably redacted before disclosure takes place. Attendance notes and other correspondence should not ordinarily be disclosed, but the judge conducting the assessment may require the disclosure of material of this kind if a genuine issue is raised. A genuine issue is one in which there is a real chance that the CFA is unenforceable as a result of failure to satisfy the applicable conditions.”⁹⁷

⁹⁷ Above, at para 220.

Post *Hollins v Russell*

4.92 It was hoped for a time that *Hollins v Russell* could abate the litigation arising from technical challenges to the validity of conditional fee agreements. However, the underlying problem of the recoverability of success fees and ATE insurance premiums remains. Hence, even with the abolition of the various detailed conditional fee regulations from 1 November 2005,⁹⁸ technical challenges to conditional fee agreements are not likely to be brought to an end – only different arguments will be deployed. Future technical challenges are likely to be based on material breaches of the Solicitors Practice Rules, the availability of BTE insurance cover, and breaches of the detailed regulations in respect of conditional fee agreements entered into before the repeal of the regulations on 1 November 2005.⁹⁹

4.93 It can be seen from the cases discussed below that if the defendant's lawyers can establish that the claimant's lawyers have not given adequate advice as to alternative funding mechanisms, or that there has been an adverse effect on the administration of justice, then it is likely that the conditional fee agreement will be declared as unenforceable and any costs recovery from the defendant will be precluded.

***Bowen v Bridgend County BC*¹⁰⁰**

4.94 This case was decided in the Supreme Court Costs Office and concerned ten consolidated claims for costs arising out of housing repair litigation. All the claimants were inhabitants of council houses who brought actions for damages for disrepair and orders for specific performance to carry out repairs to their houses. The claimants were without means and would have qualified for public funding assistance from the Legal Services Commission. A claims intermediary, which adopted "cold calling" and advertising sales techniques, had referred the claimants to solicitors in Liverpool. The cases were all settled for relatively modest sums between £750 and £3,000, but the significance of the case relates to Master O'Hare's findings as to the effect of the quality of legal advice given pursuant to the relevant regulations on the enforceability of conditional fee agreements.

4.95 The defendant contended that the claimants solicitors had failed to comply with the relevant subsidiary regulations and the failure had an adverse effect on the protection afforded to the claimants, as well as upon the proper administration of justice. Master O'Hare found that the claimants' solicitors had failed to consider whether the client had existing insurance, and had failed to consider other methods of financing the litigation costs. He found that all the claimants should have been told to seek legal aid. Master O'Hare found that the failure to consider existing insurance did not have a materially adverse effect upon the protection afforded to the claimants in the

⁹⁸ See discussion in previous chapter.

⁹⁹ Andrew Hogan, *Conditional Fees: Problems Solved and Problems Yet To Come*, Journal of Personal Injury Law 2006, 1, 40-60.

¹⁰⁰ March 25, 2004 Supreme Court Costs Office (SCCO).

case because the likelihood that they had BTE insurance was minimal. However, the failure to consider other funding methods had had a material adverse effect.

4.96 Further, Master O'Hare found that the failure to consider BTE insurance or other funding methods had had a materially adverse effect upon the proper administration of justice. He held that the solicitors' failure to comply with the regulations had steered the claimants into litigation which had caused them and the defendant to incur unnecessary and unreasonable expenses, and the solicitors knew, or should have known, that the litigation was run in a disproportionate way.

Samonini v London General Transport Services Ltd¹⁰¹

4.97 The claimant in this case was a cab driver who settled for damages of less than £2,000. He used a conditional fee agreement and the ATE premium amounted to £798. The defendant alleged that inadequate enquiries had been made as to the existence of BTE insurance and this had resulted in a materially adverse effect upon the protection afforded to the client and upon the proper administration of justice. In respect of the latter, the defendant's solicitors submitted that if solicitors were permitted to skimp on the proper investigation of BTE insurance, this would generate costly satellite litigation and impose pressure on the resources of the court. There would be no improvement in the way in which solicitors conducted these proceedings and the result would be a materially adverse effect upon the proper administration of justice. Chief Master Hurst accepted the defendant's argument and the conditional fee agreement was held to be unenforceable.

Garbutt v Edwards¹⁰²

4.98 This Court of Appeal case deals with the effect of a breach of the Solicitors' Practice Rules on the solicitor-client retainer, and the extent to which a paying party (the defendant) can rely on the breach to avoid paying the claimant's costs.

4.99 The case related to a boundary dispute in which the quantum of costs was just over £3,000. The defendant contended that the claimant's solicitors had failed to provide his clients with an estimate of the likely costs of the application; there was no liability on the part of the claimants and hence no liability on the defendant given the costs indemnity rule. The fact that hourly rates and other costs information had been provided was taken into account.

4.100 The Court of Appeal concluded that failure to give a costs estimate did not prevent the formation of a retainer nor did it render the contract unenforceable. Arden LJ stated that not every breach of the client

¹⁰¹ [2005] EWHC 9001.

¹⁰² [2005] EWCA Civ 1206.

care code would render the contract of retainer unenforceable. The breach had to be serious or there had to be persistent and material breaches.

Garrett v Halton BC and Myatt v National Coal Board¹⁰³

4.101 The jointly heard cases of *Garrett and Myatt* are recent technical challenges to the validity of conditional fee agreements for breach of the regulations.¹⁰⁴ The Court of Appeal's decisions in this case were regarded to have effectively removed the protection that claimants' solicitors got from *Hollins v Russell* against minor breaches of conditional fee regulations having disproportionate consequences. The results of the Court of Appeal's decisions are:

- A claimant's solicitors will be unable to recover costs under a conditional fee agreement if the solicitors fail to ask sufficiently detailed questions as to whether a client has a BTE insurance policy. This is true whether or not the client in fact held a valid BTE insurance policy; that is, whether the client had suffered actual loss as a result of failure to comply with a condition in the regulations was not relevant to the question whether the solicitor had breached a condition.
- A claimant's solicitors will be unable to recover costs under a conditional fee agreement if the solicitors fail to disclose indirect financial interest in recommending an ATE insurance.

Other recent technical challenges

4.102 It seems that there are still considerable uncertainties surrounding the conditional fee regime that have been resolved only by litigation. Examples include:

- A client had entered into a conditional fee agreement with a firm of solicitors, but the responsible solicitor had changed firms twice while the litigation was continuing. The costs judge ruled that the conditional fee agreement had been validly assigned to each new firm. The defendant appealed, contending that the agreement was not enforceable as against the claimant after the first purported assignment, and that the defendant was not liable to indemnify the claimant for any costs thereafter incurred. The court dismissed the defendant's appeal and ruled that both the benefit and burden of the conditional fee agreement could be assigned as an exception to the general rule that a benefit could be assigned but that a burden could not.¹⁰⁵

¹⁰³ [2006] EWCA Civ 1017.

¹⁰⁴ The decisions do not affect cases commenced after November 2005, because the relevant regulations were repealed from that date. See Chapter 3 above.

¹⁰⁵ *Jenkins v Young Bros Transport Ltd* [2006] EWHC 151(QB).

- The defendant bus company tried to argue that the claimant's letter of retainer with the claimant's solicitors was a conditional fee agreement which did not comply with the regulations. The Court of Appeal held that advising a client as to whether he had a good case and writing a letter of claim was not enough to amount to litigation services, and the retainer letter was not a conditional fee agreement.¹⁰⁶

Defamation cases

*King v Telegraph Group Ltd*¹⁰⁷

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

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

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

4.106 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*

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Gaynor v Central West London Buses Ltd [2006] EWCA Civ 1120.

¹⁰⁷

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

other party's lawyers, but this is not the time or place to discuss the occasions when that would be the appropriate weapon." [para 105]

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

Turcu v News Group Newspaper Ltd¹⁰⁸

4.107 Defamation litigation under the English conditional fee regime causes problems which have given rise to concern that freedom of expression may be inhibited. The facts of this case are rather unusual. The claimant used a false identity, did not take part in the trial and did not even serve a witness statement. The solicitor represented the claimant on the basis of the instructions received from the claimant, but without the advantage of the client's evidence to back up those instructions. The defendant newspaper was denied the opportunity not only of cross-examining the claimant, but also of even seeing evidence denying the published allegations.

¹⁰⁸

[2005] EWHC 799 QB.

4.108 The claimant was able to pursue his claim for damages purely because the solicitor was prepared to act on a conditional fee basis. Significant costs were run up for the defendant without any prospect of recovery if they were successful. This is the so-called “chilling effect” or “ransom factor”. The trial lasted from 5 to 18 April 2005. The claimant’s action was dismissed, and the defendant’s costs were substantial and irrecoverable.

Campbell v Mirror Group Newspaper Ltd¹⁰⁹

4.109 This case demonstrates that the use of conditional fee agreements is increasing in defamation cases, resulting in disproportionately high costs. While England’s conditional fee regime might prove workable for straightforward cases, that might not be so for defamation and other high risk cases.

4.110 The case concerned a privacy (breach of confidence) claim, and the House of Lords had to consider the balance between the right of access to the courts and the right of free expression. The damages were £3,500 but the winner’s costs amounted to more than £1 million. The defendant newspaper filed a petition to object to the success fee as being disproportionate, and claimed that their freedom of expression had been infringed.

4.111 In contrast to the *King v Telegraph* case, the claimant, Naomi Campbell, was considered good for her own lawyers’ costs and any adverse costs. Lord Hoffmann pointed out that when one has to balance rights such as freedom of expression against other rights such as privacy or access to a court, there has to be an intense focus on the comparative importance of the specific rights being claimed in the individual case, although concentration on the individual case does not exclude recognising the desirability, in appropriate cases, of having a general rule in order to enable the scheme to work in a practical and effective way.¹¹⁰ Lord Hoffmann said the impracticality of requiring a means test, and the small number of individuals who could be said to have sufficient resources to provide them with access to legal services, entitled Parliament to lay down a general rule that conditional fee agreements are open to everyone.¹¹¹ The House of Lords found that there was nothing in the statutory regime to limit the use of conditional fees to the impecunious. The defendant’s petition was dismissed.

Summary of main issues

4.112 While there has been much judicial consideration of various aspects of conditional fees, there remains considerable uncertainty as to the position in respect of a number of important issues. Most problematic, it

¹⁰⁹ [2005] UKHL 61.

¹¹⁰ [2005] UKHL 61, at para 26.

¹¹¹ At para 27.

seems, are the ATE premiums, especially as to the appropriate amount of ATE premiums (“the reasonableness issue”).¹¹²

4.113 A further difficulty arises where there is pre-existing BTE insurance. There may then be a dispute as to whether the claimant should have relied on the defendant’s BTE insurance instead of taking out his own ATE insurance.¹¹³ The decision turns on whether the pre-existing BTE cover is “satisfactory” for a claim of that particular size.

4.114 The Court of Appeal tried to contain the uncertainties surrounding conditional fee agreements in *Hollins v Russell* by clarifying that only “material” breaches of the requirements would render a conditional fee agreement unenforceable. However, this is unlikely to be the end of satellite litigation because whether a breach is “material” or not is open to interpretation. The effect is shown also by post *Hollins v Russell* cases – the satellite litigation continued but the issues have changed.

4.115 There has been a string of case law¹¹⁴ on which types of conditional fee arrangements were permissible under the common law. The current common law position on maintenance and champerty is defined in *Wallersteiner v Moir* (No 2)¹¹⁵ and explained in *Awwad v Geraghty & Co.*¹¹⁶ In the words of Lord Denning in *Wallersteiner v Moir* (No 2), “*English law has never sanctioned an agreement by which a lawyer is remunerated on the basis of a „contingency fee“, that is that he gets paid the fee if he wins, but not if he loses. Such an agreement was illegal on the ground that it was the offence of champerty.*”¹¹⁷ Hence, unless a conditional fee agreement fully complies with the relevant legislation which sanctioned conditional fees, the conditional fee agreement would not be enforced.

4.116 Given that the conditional fee regulations were repealed in November 2005,¹¹⁸ the client protection provisions that a conditional fee agreement has to comply with are moved to the Solicitors’ Practice Rules. The English Court of Appeal held in *Awwad v Geraghty & Co* that the Solicitors’ Practice Rules 1990, being made under section 31 of the Solicitors Act 1974, were secondary legislation which had the force of statute. Breach of the Rules not only infringed regulation of professional practice, but was unlawful. Hence, except for trifling breaches, non-compliance with the Solicitors’ Practice Rules would render a conditional fee agreement unenforceable. The result is that it is not only claimants who are trying to find flaws in conditional fee agreements; defendants’ solicitors are also looking for flaws so that the defendant can avoid paying the claimants’ legal costs under the costs indemnity rule.

¹¹² See Lord Hoffmann’s dictum in *Callery v Gray*, cited above and also *Sarwar v Alam and Claims Direct Test Cases*.

¹¹³ See *Sarwar v Alam*, cited above.

¹¹⁴ See *British Waterways Board v Norman*, *Thai Trading Co v Taylor*, *Awwad v Geraghty & Co*, all cited above.

¹¹⁵ [1975] QB 373.

¹¹⁶ [2000] 3 WLR 1041. See discussion above in this chapter.

¹¹⁷ [1975] QB 373 at 393.

¹¹⁸ See discussion in Chapter 3.

4.117 In addition to these problems, issues posed by the operation of claims intermediaries have attracted litigation.¹¹⁹ The issue will be discussed further in this paper.¹²⁰

4.118 Conditional fees have certainly come under criticism since their introduction in 1995. As well as the issues highlighted above, the simple fact that a losing defendant is liable to pay not only the plaintiff's taxed costs, but also the success fee of the plaintiff's solicitors and the relevant insurance premium, has caused much controversy and satellite litigation. Defendants still consider it unfair that these extra costs can be incurred at the outset, before they have been given an opportunity to settle an obvious claim.¹²¹ It remains in the interests of the losing defendant to challenge the uplift on taxation, or by costs only proceedings, and as a result the courts have found themselves in the position of cutting back significantly on the success fee agreed and approved by the plaintiff's solicitors and the plaintiff. For some time this caused plaintiffs' solicitors difficulties, since the fees charged by a conditional fee practice are calculated on the assumption that the success fees in winning cases will outweigh those instances where a case is lost and the firm recovers nothing. The court's intervention in that process has caused problems, but it is fair to say that the passage of time and experience has led to the standardisation of success fees, which are less often reduced by the Court on taxation.

4.119 Significant efforts have been devoted to simplifying the conditional fee regime. It remains to be seen whether this will reduce the amount of satellite litigation, in which the losing party challenges the conditional fee agreement in the hope of avoiding liability for costs altogether. Nevertheless, the fact that the losing party must pay the success fee, together with the insurance premium, remains a source of much contention and public policy debate. Hogan¹²² considered the underlying cause of all the problems inherent with England's conditional fee regime was recoverability of the success fee and insurance premium. However, recoverability remained intact after the legislative changes in November 2005. Hogan believed that the problems would continue to manifest themselves under the revised conditional fee regime.

4.120 On a more positive note, the conclusion appears to be that access to justice has been increased, primarily in the field of personal injury, but also in other areas such as insolvency, *pro bono* and charitable work, and defamation, as well as other personal or commercial actions for parties who fall outside the shrinking scope of legal aid, but are unable to fund the litigation personally.

¹¹⁹ See *English v Clipson*, cited above.

¹²⁰ See Chapter 6.

¹²¹ Following *Callery v Gray*, (Nos 1 and 2) [2002] 1 WLR 2000-2032.

¹²² Andrew Hogan, "Conditional Fees: Problems Solved and Problems Yet to Come", *Journal of Personal Injury Law* 2006, 1, 40-60.

Chapter 5

Outcome-related fees in other jurisdictions

Introduction

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

Australian jurisdictions – general observations and recent trends

5.2 Following the abolition of the offence and tort of maintenance and champerty in the United Kingdom in 1967, the Australian jurisdictions of Victoria, South Australia and New South Wales followed suit in 1969, 1992 and 1995 respectively.¹ Maintenance and champerty have also been abolished in the Australian Capital Territory.² In Queensland, although maintenance and champerty remain actionable torts,³ they were never included as offences in the Criminal Code Act 1899 (Qld). Solicitors in Queensland are now permitted to fix their fees by an agreement which may stipulate a percentage.⁴

5.3 The Federal Court of Australia has commented that it is plainly unsatisfactory that maintenance of litigation remains a civil wrong in some states in Australia.⁵ Whether there remain valid reasons for the retention of the tort at common law has not been addressed although it has long been considered obsolete. In *Clyne v New South Wales Bar Association*,⁶ the High Court suggested that it may be necessary to consider whether it ought now to be so regarded. In *Halliday v High Performance Personnel Pty Ltd*,⁷ Mason CJ also appears to have assumed that the status of the tort was questionable.⁸

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

² John North, "Litigation funding: Much to be achieved with the right approach" (Dec 2005), Law Society Journal, at p 67.

³ See *J C Scott Constructions v Mermaid Waters Tavern Pty Ltd* [1984] 2 Qd R 4B.

⁴ Per judgment in *Magic Menu Systems Pty Ltd*, cited above.

⁵ In *Magic Menu Systems Pty Ltd*, cited above.

⁶ (1960) 104 CLR 186.

⁷ (1993) 113 ALR 637.

⁸ Per judgment in *Magic Menu Systems Pty Ltd*, cited above.

5.4 A recent study⁹ found that in New South Wales, for example, the last 20 years have seen a move away from reliance on legal aid, and ordinary claimants now rely on law firms using conditional fees. As for commercial cases, these are funded either by the client or by litigation funders. There is, however, no ATE insurance and no funding in respect of adverse costs. Lawyers acting on a conditional fee basis may charge up to 25% of the time charge as a success fee but, unlike the position in England, the success fee is not recoverable from the paying party.

5.5 The same study also pointed out that the tort law reform in New South Wales has a chilling effect on litigation. Proceedings for personal injuries have been restricted to cases in which the claimant has sustained a permanent disability of more than 15%, and if the claim is under \$100,000, there is a limit on the amount that can be claimed as costs from the defendant. Cases issued in the District Courts have dropped significantly from 22,000 cases in 2001/2002 to 8,000 cases in 2002/2003. The study found that judges, lawyers and officials in New South Wales generally are of the view that the tort reforms have gone too far and that some relaxation is required.¹⁰

5.6 As for Victoria, which also allows conditional fees and a 25% success fee, statutory scales are used to determine the costs payable by an unsuccessful party to a successful one. The Costs Co-ordination Committee, with representatives from all levels of courts, the government and professional bodies, fixes the scales annually, taking into account indexed prices from the Australian Bureau of Statistics. The system is accepted by practitioners and the amount recoverable between the parties under the scales is equal to approximately two thirds of the solicitor and client costs.¹¹

5.7 It is interesting to note that road traffic accidents cases in Victoria are dealt with outside the courts. The use of alternative dispute resolution is compulsory. For employer's liability cases, unless the claimant has sustained more than a 30% disability, he cannot sue in negligence but must use the Workman's Compensation Scheme. Further, the Victorian Civil and Administrative Tribunal ("VCAT") consolidated the previous 12 boards and tribunals, and deals with a wide range of matters including consumer matters, credit, discrimination, domestic building works, guardianship, tenancies, planning and decisions of various government agencies. Within the designated fields, the VCAT has unlimited jurisdiction but no costs are awarded.¹²

⁹ England's Civil Justice Council, *Report on Improved Access to Justice – Funding Options & Proportionate Costs*, Aug 2005.

¹⁰ England's Civil Justice Council, cited above, at pages 75-76.

¹¹ England's Civil Justice Council, cited above, at pages 76-77. This level of costs recovery is comparable to that under "party and party" taxation in the High Court of Hong Kong (see Kaplan, J in *Commissioner of Inland Revenue v Aspiration Land Investment Ltd* (1990) IR App No 10 of 1999 referred to in Hunsworth, *Law Lectures for Practitioners* 1991).

¹² England's Civil Justice Council, cited above, at pages 77-78.

Litigation funding companies, class actions and conditional fees

5.8 There appears to be increasing use of litigation funding companies, class actions and conditional fees in Australia. A proponent¹³ of this trend has pointed out that the courts have over time relaxed their treatment of litigation funding. Initially, this was allowed for bankruptcy or winding-up proceedings, but more recently it has also been allowed in respect of class actions. A notable example is *Campbells Cash and Carry v Fostif Pty Ltd*.¹⁴ The case involved a large number of tobacco retailers recovering licence fees paid to a wholesaler. The amounts of each retailer's claim were too small to justify legal action, but Firmstone, a litigation funding company, approached a number of affected retailers and then brought a class action, at the same time seeking to use the discovery process to identify all other members of the class.

5.9 The defence in *Fostif* argued that Firmstone was in effect trafficking in litigation, and that this kind of involvement constituted an abuse of process. However, by a majority of 5:2, the High Court handed down a decision in favour of litigation funding. Under the funding agreement, the funder had effective control of the proceedings.¹⁵ The funder would pay the costs of the proceedings and would meet all cost orders made against the claimant. In return, the funder would receive 33% of the amount recovered from the defendant.

5.10 The majority judges felt that to disapprove of litigation funding was too drastic a step to take, and they saw no problem in the funder making a profit from the litigation.¹⁶ It has been said that the case represented a significant shift in thinking and modernised views about litigation funding, and maintenance and champerty. The court endorsed the view that funded litigants should not attract special attention and ought to be subject to the same laws and rules as all other litigants, and that the court, when determining whether to stay or dismiss funded proceedings for an abuse of process, ought not to concern itself with the terms of the arrangement between the funder and the plaintiffs.¹⁷ The funder, however, lost the appeal on procedural grounds.

5.11 In an article on litigation funding, the President of the Law Council of Australia expressed the view that the involvement of a litigation funding company, to gather and administer all members of the class, could be a reasonable means of reducing legal costs. The involvement of litigation funding companies could ensure that all interested parties were given the opportunity to opt into proceedings. According to the article, the large number of challenges to litigation funding agreements raised by defence lawyers on the basis of champerty and maintenance in recent years had compelled the Standing Committee of Attorneys-General to consider whether regulation of litigation funding companies was necessary.

¹³ John North, President of the Law Council of Australia, in "Litigation funding: Much to be achieved with the right approach" (Dec 2005), Law Society Journal (NSW).

¹⁴ [2006] HCA 41. Decision handed down on 30 August 2006.

¹⁵ The funder is authorised to conduct the representative proceedings (or the class action), and to settle with the defendants provided that the settlement was at least 75% of the amount claimed.

¹⁶ Minter Ellison, Legal Insights, 12 September 2006.

¹⁷ As above.

5.12 In another article,¹⁸ critics of the combined use of conditional fees and class actions said that one of the adverse effects of conditional fee agreements has been the sudden increase of marginal claims commenced to encourage nuisance value settlements. It was said that the mere prospect of expensive and protracted litigation involving multiple litigants would force a settlement offer at an early stage.

Overview of conditional fees in Australian jurisdictions

5.13 A report published in 2000 by the Australian Law Reform Commission¹⁹ ("the ALRC") entitled *Managing Justice – A review of the federal civil justice system 2000* found that it was common for lawyers to engage in conditional and speculative fee arrangements.²⁰ The ALRC found that the lawyers in those cases carried much of the financial risk and provided considerable low cost assistance in financing litigation.²¹ The speculative and conditional fee arrangements had also assisted in promoting parties' access to the litigation process.²²

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

- The Trade Practices Commission in 1994 recommended that lawyers should be permitted to charge an uplift to a maximum of 25%, but not a percentage of the award.²³
- The Australian Attorney-General's Department in its *Justice Statement* of May 1995 recommended the introduction of conditional fees, except in family and criminal law cases. This should be accompanied by safeguards for clients, such as a requirement that lawyers assess the risks of winning or losing a case and provide a written assessment of these risks to clients when proposing the conditional fee arrangement.
- The Access to Justice Advisory Committee in its 1994 report recommended the introduction of conditional fees, except in family and criminal matters, and subject to safeguards, with a maximum uplift of 100%.²⁴

¹⁸ Stuart Clark, *Learning from Australia's CFA lessons*, The Lawyer July 31, 2000.

¹⁹ Report No 89.

²⁰ According to ALRC's own survey in the Federal Court, about 3% of the cases involved a speculative fee arrangement and about 13% of the cases involved a conditional fee arrangement.

²¹ ALRC, cited above, at 12.

²² As above. See also section 65 Australia's Supreme Court Act.

²³ *Study of the Profession – Legal*, Final Report TPC, Canberra.

²⁴ *Access to Justice – An action plan*.

- The ALRC in a 1988 report on group proceedings recommended conditional fees should be available for such proceedings, subject to court approval.²⁵
- The Business Working Group on the Australian Legal System in its 1998 paper opposed conditional fees on the basis that they could encourage applicants to file marginal suits for their possible nuisance settlement value.²⁶

5.15 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.²⁷ Unlike the United States, contingency fees calculated as a percentage of the sum awarded by the court are not permitted in Australia.²⁸ With regard to uplift fees, the rules vary in different states of Australia:

New South Wales

- Up to 25% uplift fee is allowed (Legal Profession Act 1987)

Victoria

- Up to 25% uplift fee is allowed (Legal Practice Act 1996)

South Australia

- Up to 100% uplift fee is allowed (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))

²⁵ *Grouped proceedings in the Federal Court.*

²⁶ *Trends in the Australian legal system – avoiding a more litigious society.*

²⁷ ALRC, cited above at para 5.21.

²⁸ As above.

Western Australia

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

5.16 For both speculative and conditional fee arrangements, the litigant carries the risk of having to pay the costs of the other party if the claim is unsuccessful, and is also responsible for the disbursements incurred by his lawyer.²⁹ Some lawyers arrange litigation loans for clients from banks, usually for payment of disbursements only.

5.17 The ALRC stated that conditional fee arrangements are commonly used in money claims, including personal injury and workers' compensation matters. However, "*their implementation has not created a flood of litigation, nor is there evidence that such arrangements encourage people to pursue unmeritorious claims.*"³⁰ In fact, conditional fee agreements may actually work to filter out unmeritorious claims, as lawyers will not be prepared to bear the risk in such cases.

5.18 Although conditional fee arrangements are usually made between individual litigants and their lawyers, federal legislation has been passed to legalise litigation funding schemes which are established to assist liquidators and trustees in bankruptcy in insolvency and bankruptcy matters.³¹

5.19 The ALRC noted that Justice Corporation Pty Ltd proposes to provide fees and disbursements to litigants in return for sharing a percentage of the damages awarded, without any other involvement in the case. Views are divergent about the legality of this scheme. Even for states that have abolished the old common law tort and criminal offence of maintenance and champerty, the arrangement might be considered illegal and void in contract law as being contrary to public policy.³²

5.20 The ALRC stated its support for an extension of conditional fee schemes and litigation lending in the federal jurisdiction provided such schemes were carefully controlled to protect consumers and the administration of justice. The ALRC did not support the introduction of contingency fees based on a percentage of the amount awarded.³³

²⁹ ALRC, cited above, at para 5.23.

³⁰ ALRC, cited above, at para 5.24.

³¹ ALRC, cited above, at para 5.25.

³² ALRC, cited above, at para 5.25.

³³ ALRC, cited above, at para 5.26.

Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd

5.21 It may be of interest to note the observations of the Federal Court in *Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd*.³⁴ AFA Facilitation funds the costs and disbursements of litigation, in return for 20% of any compensation, award or negotiated settlement. While the court decided the case on an unrelated point of law, observations were made as to what might be considered to be contrary to public policy. The court noted that:

“... concerns expressed earlier this century, as to the potential for the maintenance of actions to give rise to an increase in litigation, might now be considered of lesser importance than the problems which face the ordinary litigant in funding litigation and gaining access to the courts. ... [s]upport of legal proceedings based upon a bona fide common interest, financial or philosophical, must be permitted if the law itself was not to operate as oppressive. The Courts today, in our view, are likely to take an even wider view of what might be acceptable, particularly if procedural safeguards are present or able to be applied.”

Smits v Roach³⁵

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

- At common law, a legal practitioner could not bargain for an interest in the subject-matter of the litigation, which included seeking remuneration calculated as a proportion of the amount that may be recovered by the client in the proceedings. A legal practitioner entering into such an arrangement could not recover any fees, either under such an agreement or on a *quantum meruit* basis.
- Amendments to the Legal Profession Act 1987 (NSW) in 1993 allowed conditional costs agreements and the uplift of fees to a maximum of 25%, but provided that costs could not be determined as a proportion of, or vary in accordance with, the amount recovered in proceedings. Any provision of an agreement inconsistent with those provisions was void to the extent of the inconsistency.

³⁴ (1997) 72 FCR 261.

³⁵ Judgment given on 19 June 2002 – Sydney, 42 ACSR 148.

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

Legal Practice Act 1996, Victoria

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

"97. Costs agreements may be conditional on success

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

98. Uplifted fees are allowed

- (1) A conditional costs agreement may provide for the payment of a premium on the legal costs otherwise*

payable under the agreement on the successful outcome of the matter in respect of which the agreement is made.

- (2) *The premium must be a specified percentage of the legal costs otherwise payable, and must be separately identified in the agreement.*
- (3) *A legal practitioner or firm must not enter into a conditional costs agreement under which a premium, other than a specified percentage not exceeding 25% of the costs otherwise payable, is payable on the successful outcome of any matter involving litigation.”*

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

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

5.25 A legal practitioner or firm that has entered into a costs agreement in contravention of section 97(5), 98(3) or 99(1) is not entitled to recover any amount in respect of the provision of legal services in the matter, and must repay any amount received.³⁶ The client will be entitled to recover the amount from the practitioner or firm as a debt if it is not repaid.³⁷

5.26 Other relevant provisions include:

- A costs agreement must be written or evidenced in writing, and may consist of a written offer that is accepted in writing or by other conduct.³⁸
- If the costs agreement is not fair and reasonable or if the client was induced to enter into the agreement by fraud or misrepresentation, then the client may apply to a tribunal to cancel the costs agreement.³⁹

³⁶ Section 102(3).

³⁷ Section 102(4).

³⁸ Section 96(2), (3).

³⁹ Section 103.

Comments of the Law Institute of Victoria

5.27 In September 1999, the President of the Law Institute of Victoria, Mr Michael Gawler, referred to reports in the media that the courts were being swamped with new civil actions and that Australia was becoming a more litigious society. The Law Institute pointed out that the number of cases before the courts had actually declined.⁴⁰ Mr Gawler said it was important to distinguish between the myth and the reality of civil litigation, and that a huge majority of Australians were still unable to use the court system because they could neither afford lawyers' fees nor obtain legal aid.

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

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

Legal Profession Act 1987, New South Wales

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

"186 Conditional costs agreements

- (1) *A barrister or solicitor may make a costs agreement under which the payment of all of the barrister's or solicitor's costs is contingent on the successful outcome of the matter in which the barrister or solicitor provides the legal services.*
- (2) *Any such costs agreement is called a conditional costs agreement.*

⁴⁰

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

- (3) *A conditional costs agreement may relate to proceedings in a court or tribunal, except criminal proceedings.*
- (4) *A conditional costs agreement must set out the circumstances constituting the successful outcome of the matter.*
- (5) *A conditional costs agreement may exclude disbursements from the costs that are payable only on the successful outcome of the matter.*

187 Payment of premium under conditional costs agreement

- (1) *A conditional costs agreement may provide for the payment of a premium on those costs otherwise payable under the agreement only on the successful outcome of the matter.*
- (2) *The premium is to be a specified percentage of those costs or a specified additional amount. The premium is to be separately identified in the agreement.*
- (3) *The premium is not to exceed 25% of those costs.*
- (4) *However, the regulations may vary that maximum percentage of costs. Different percentages may be prescribed for different circumstances.*

188 Costs not to be calculated on amount recovered in proceedings

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

5.31 As in Victoria, any costs agreement in New South Wales should be in writing or evidenced in writing, and a costs agreement is void if it is not in writing or evidenced in writing.⁴¹ In Victoria, the costs agreement is also void, but the legislation provides that the legal practitioner or firm may recover “the reasonable value of the legal services provided”.⁴²

⁴¹ Section 184(4) Legal Profession Act 1987, New South Wales.
⁴² Section 93(c) Legal Practice Act 1996, Victoria.

Legal expenses insurance in Australia

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

5.33 Legal expenses insurance is provided in three main ways:

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

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

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

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

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

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

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

5.37 The VLRC pointed out that the first two problems were met by the group insurance schemes. One of such schemes is operated by Legal Expenses Insurance Ltd (LEI) incorporated in New South Wales in May 1988. LEI has deliberately focused on group schemes in order to increase the opportunities to spread the risk amongst the largest group of policy holders, and to avoid the risk of adverse selection. The third problem, conflicts of interest, arises where an insurance company offers legal expenses insurance to its own customers. In England, there is a European Community directive to avoid conflicts of interest between insurers and their clients. In the United Kingdom, legal expenses insurance is sold by specialist legal insurance companies because, if the insurer holds both the insurance of the primary risk and of the legal expenses, the insurer might be in a position to give legal advice to clients in matters in which it was financially involved. The European Community directive requires an insurer to have separate claims and management divisions, and prefers a separate company to underwrite the additional insurance. In the United Kingdom, four groups provide wholesale legal expenses insurance to the normal insurance industry and the wholesalers execute most of the legal work in-house. The conflict of interest in “add-on” legal expense insurance has been avoided by the Australian proposal because LEI is a separate specialist insurance company and is independent of the insurer of the primary risk.

Canadian jurisdictions

5.38 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. According to one source,⁴³ contingency fees have received few complaints from the public, and have 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.

5.39 Canadian jurisdictions adopt the costs indemnity rule, but there is no ATE insurance available.⁴⁴ There is a no fault scheme for low value road traffic accident cases and employers’ liability claims are dealt with under a Workers Compensation Scheme.

⁴³ Judd Epstein, *The Key to the courthouse: the introduction of contingency fees in Victoria*, December 1987, 61 *Law Institute Journal* 1264-1267.

⁴⁴ England Civil Justice Council, *Report on Improved Access to Justice – Funding Options & Proportionate Costs*, Aug 2005.

Ontario

5.40 In September 1999, the Attorney General of Ontario expressed an interest in contingency fees and directed that a Ministry discussion paper on the subject be prepared in consultation with the Advocates' Society, the Canadian Bar Association (Ontario) and the Law Society. As a result, a Joint Committee on Contingency Fees ("the Joint Committee") was established, consisting of representatives from these organisations and Ministry staff, to carry out this task.⁴⁵

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

- (a) Forty-six percent of respondents said that a lawyer's fee had a major impact on their decision to hire a lawyer, whereas 20% said it had little or no impact.
- (b) At the beginning of the survey, 70% of respondents (after receiving an explanation of how contingency fees work) "strongly" or "somewhat" agreed that the Ontario government should allow people to hire lawyers on a contingency basis.
- (c) Forty-nine percent of respondents said that they would be more supportive of contingency fees if they knew that, with contingency fees, more people might feel that they could afford the services of a lawyer for a court case.
- (d) Forty-eight percent of respondents said that they would be more supportive of contingency fees if they knew that there was to be legislation that would limit the percentage of a settlement that a lawyer would be permitted to take.
- (e) Forty-five percent of respondents said that they would be more supportive of contingency fees if they knew that there was to be legislation that would give clients, in the event of a dispute, the right to ask a judge to review their contingency fee arrangements.
- (f) At the end of the survey, the level of support amongst respondents for contingency fees had increased to 75%.

Joint Committee's proposed regulatory scheme

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

⁴⁵ Joint Committee on Contingency Fees, *Report from Society's Representative on Joint Committee on Contingency Fees* to Convocation, 23 June 2000, Ontario.

- (a) Contingency fees would be permitted in litigation matters, other than in criminal law and family law proceedings.
- (b) The maximum contingency fee rate would be capped at 33%.
- (c) Notwithstanding the cap, a lawyer would be permitted to apply to the court, at the time of entering into a contingency fee arrangement, for approval to charge a contingency fee rate in excess of the cap. The application would be heard by a judge in chambers. It would be mandatory for the client to appear at the hearing of the application. In determining whether to grant the application, the judge would be required to consider the nature and complexity of, and the expense and risk involved in, the case.
- (d) The contingency fee rate would apply to the amount recovered by the client, exclusive of any costs awarded, and exclusive of disbursements.
- (e) Costs would be dealt with outside the contingency fee scheme. If costs were awarded, they would go to the client.
- (f) Disbursements would be dealt with outside the contingency fee scheme. The client would be responsible for reimbursing the lawyer for all disbursements made. However, it would be open to the client to negotiate for the lawyer to assume responsibility for payment of disbursements.
- (g) There would be no restrictions on who could enter into a contingency fee arrangement with a lawyer. Specifically, there would be no prohibition against minors or persons under a legal disability from entering into contingency fee arrangements.
- (h) Certain standard information and terms would have to be included in every contingency fee contract. A lawyer would be prohibited from including other terms in a contingency fee contract.
- (i) A client would be entitled to ask a judge to review a contingency fee contract, and any charges rendered to the client under the contract,
 - (i) absolutely within one month after delivery of the lawyer's bill, and
 - (ii) at the discretion of a judge, within twelve months after payment of the lawyer's bill.
- (j) The regulation of contingency fees would be the responsibility of the government, implemented through amendments to the *Solicitors Act*.

5.43 Contingency fees are now allowed in Ontario.⁴⁶ In *Raphael Partners v Lam*,⁴⁷ the Ontario Court of Appeal upheld as reasonable and enforceable a contingency fee of 15% of the first \$1 million recovered, and 10% of each additional \$1 million plus any costs recovered paid by the defendant. As \$2.5 million was recovered, the costs allowed were \$461,000 excluding disbursements.

Ireland

5.44 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. As for conditional fees, the general view is that these 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. Success fees are allowed, but it is reported⁴⁸ that conditional fees are seldom used in Ireland.

5.45 Contingency fees are prohibited, but a detailed analysis⁴⁹ of personal injury cases showed that the actual fees charged by solicitors in those cases could be explained only as the aggregate of a flat fee plus 15% of the sum recovered. Professor Faure's report pointed out that this could indicate that allowing outcome-related fees (which are permitted in Ireland) could possibly have the unintended consequence of engendering the charging of contingency fees. On the other hand, it is also possible that the prohibitions against contingency fees are willingly ignored.

Mainland China

5.46 Before 2006, four sets of measures regarding fee charging by lawyers had been promulgated in the Mainland.⁵⁰ The last set was promulgated in 1997 with the title of *Temporary Management Measures of Fee Charging for Lawyers' Services*⁵¹ (the "1997 Temporary Management Measures"). Outcome-related fees were not featured in any of these sets of measures. In 2000, the *National Planning Committee and the Ministry of Justice issued a Temporary Notice on the Establishment of Provisional Fee Charging Standards for Lawyers by Various Localities*⁵² (the "2000 Temporary

⁴⁶ In 2002, the Justice Statute Law Amendment Act 2002 was passed, and amendments were made to the Solicitors Act to regulate contingency fee agreements.

⁴⁷ [2002] OJ No 3605, Docket No C36894, 24 September 2002.

⁴⁸ Report commissioned by the Research and Documentation Centre of the Ministry of Justice of Netherlands, and conducted by a team led by Professor Michael Faure of the Faculty of Law of the University of Maastricht, Netherlands (2007).

⁴⁹ As above.

⁵⁰ 王進喜（中國政法大學副教授法學博士），《風險代理制度有待完善》，（2006-03-08），第二段（para 2）。(Source: <http://www.chinaweblaw.com/news/n41066c24.html>)

⁵¹ 《律師服務收費管理暫行辦法》。

⁵² 《國家計委、司法部關於暫由各地制定律師服務收費臨時標準的通知》。

Notice”) to establish their own provisional standards for fee charging based on the 1997 Temporary Management Measures. Although the 2000 Temporary Notice did not mention outcome-related fees, many localities have since then expressly permitted such fee charging arrangements – some with clear regulations, and some without.

5.47 Since 2004, it appears that outcome-related fees have been expressly allowed. In the *Rules of the Conduct of Practising Lawyers (trial)*⁵³, which were promulgated and came into force on 20 March 2004:

- (a) Article 96 stipulates that lawyers fees which are based on the outcome of litigation or other legal services should be confirmed by way of an agreement, and should clearly specify the amount and method of payment, the legal services included, the effect of settlement/conciliation on the fees payable, and whether disbursements have been included in the outcome-related fees.
- (b) Article 97 states that fees based on the outcome of litigation are not permitted when clients are involved in criminal litigation, or in civil claims in the areas of alimony/maintenance (贍養費), costs of support (扶養費) and costs of upbringing of a child (撫養費), save with instructions from the client.

5.48 The latest *Management Measures of Fee Charging for Lawyers’ Services*⁵⁴ (the “2006 Management Measures”) were promulgated on 13 April 2006 and came into force on 1 December 2006. Article 34 of the 2006 Management Measures expressly abolished the 1997 Temporary Management Measures and the 2000 Temporary Notice. Aspects of the 2006 Management Measures which are relevant to outcome-related fees are as follows:

- (a) Article 4 – Lawyers should charge service fees using the government-directed prices (政府指導價) and the market-regulated prices (市場調節價).
- (b) Article 11 – When dealing with civil cases in relation to property matters, if the client insists on the use of outcome-related fees even after being told of the government-directed prices, the law firm may charge outcome-related fees, except in respect of the following types of cases:
 - (i) Matrimonial and probate cases;
 - (ii) Requests for social security benefits or minimum living standard benefits;

⁵³ 《律師執業行為規範（試行）》。

⁵⁴ 《律師服務收費管理辦法》。

- (iii) Requests for alimony/maintenance (贍養費), costs of upbringing of children (撫養費), costs of support (扶養費), consolation money (撫恤金), relief payment (救濟金), and compensation for injuries sustained in the course of employment (工傷賠償); and
 - (iv) Requests for remuneration for work performed etc.
- (c) Article 12 – Outcome-related fees are prohibited in criminal cases, administrative cases, State compensation cases and class action cases.
- (d) Article 13 – The arrangements for outcome-related fees should be included in a fee charging contract signed between the law firm and the client which sets out the risks and obligations to be undertaken by both sides, the method of charging, and whether the fee is a fixed amount or a proportion of the claim. The maximum amount chargeable under an outcome-related fee arrangement shall not be more than 30% of the amount specified in the fee charging contract.

Northern Ireland

5.49 In Northern Ireland, under the Access to Justice (Northern Ireland) Order 2003⁵⁵ provision is made both for conditional fee agreements and an alternative, the setting up of litigation funding agreements. Civil legal aid is still in operation, but a substituted mechanism⁵⁶ is under consideration. The implementation of the Order began with the establishment of the Northern Ireland Legal Services Commission in September 2003 which is tasked with the administration of legal aid and the implementation of the remaining reforms required by the Order.⁵⁷ 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.

⁵⁵ (2003 No 435 (N.I. 10)).

⁵⁶ See judgment of Lord Carswell in *Campbell v MGN Ltd* [2005] UKHL 61.

⁵⁷ Annette Morris (Cardiff Law School), *Conditional Fee Agreements in Northern Ireland: Gimmick or Godsend?* Northern Ireland Legal Quarterly, Vol 56 No 1.

Scotland

Speculative fees

5.50 In Scotland, while civil legal aid is still available⁵⁸ lawyers have been allowed to act on a speculative basis.⁵⁹ The speculative action is usually an action for damages for personal injury. The solicitor and the advocate undertake to act for the pursuer (plaintiff) on the basis that they will not be remunerated except in the event of success and that any costs such as court fees will be defrayed by the solicitor. The courts in Scotland have long recognised that this is a perfectly legitimate basis on which to carry on litigation and that it is a reasonable way of enabling people who do not qualify for legal aid to finance costly litigation.⁶⁰ Undertaking to act on a speculative basis imposes on both advocate and solicitor special duties to satisfy themselves that there is a reasonable prospect of success. If a solicitor wishes to instruct an advocate on a speculative basis he must state the fact explicitly in his instructions and the advocate is not bound to accept.

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

5.52 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 costs indemnity rule is thus not affected by a scheme such as the speculative action. The unsuccessful pursuer remains liable for the costs of his successful opponent.

Conditional fees

5.53 In February 1997, the Law Society of Scotland introduced the Compensure scheme under which a solicitor can agree to act for a client on a “no win, no fee” basis provided the client agrees to pay an insurance premium of £115 to insure against the possibility of losing the case, in which event the insurance company will cover the client’s outlays and the opponent’s costs if awarded.⁶¹

⁵⁸ Part III of the Legal Aid (Scotland) Act 1986.

⁵⁹ Act of Sederunt (Fees of Advocates in Speculative Actions) 1992 and Act of Sederunt (Fees of Solicitors in Speculative Actions) 1992. The primary legislation from which the Lords of Council and Session derived their power to make these enactments is section 36(2) of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990. See judgment of Lord Hope of Craighead in *Campbell v MGN Ltd* [2005] UKHL 61.

⁶⁰ See *X Insurance Co v A and B* (1936), SC 239.

⁶¹ The Scottish Office Home Department, *Consultation Paper on Civil Legal Aid*, 1998 at Part 7.

South Africa

5.54 In November 1996, the South African Law Commission issued its *Report on Speculative and Contingency Fees*. Although the term "contingency fee" is used in the South African Law Commission Report, it is clear from the context that they were referring to conditional fees. The recommendations resulted in the Contingency Fees Act of 1997. By virtue of the 1997 Act, legal practitioners, including both attorneys and advocates, may enter into an agreement with a client that: (a) the legal practitioner shall not be entitled to receive any fee for services rendered in the proceedings unless the client is successful in such proceedings; and (b) in the event of success, the legal practitioner shall be entitled to fees equal to or higher than his normal fees provided that the higher fee (also referring to a "success fee") shall not exceed normal fees by more than 100%, and further provided that the success fee shall not exceed 25% of the amount awarded or obtained from the proceedings.⁶²

5.55 Conditional fee agreements can be used except in criminal or family law proceedings.⁶³ The South African Law Commission was concerned that the availability of conditional fee agreements in family law cases might encourage litigation in, for example, the field of divorce. In respect of criminal law cases, the Commission considered that those accused of crime were adequately catered for in terms of the Constitution as far as access to justice was concerned.

5.56 There are provisions⁶⁴ requiring an explanation to be given to the client that he would be liable to pay the uplift portion of the advocate's fee (in cases where counsel had to be employed) in the event of success. The basis of payment should be agreed between the attorney and his client; and the client should be advised of any other options for financing the litigation, and of their respective implications. The client should also be informed of the normal rule that he might be liable to pay the opponent's taxed party and party costs if the litigation proved unsuccessful. Finally, it should be explained to the client that there would be a cooling off period of fourteen days during which the client could cancel the conditional fee agreement.

5.57 The 1997 Act further stipulated⁶⁵ that any offer of settlement could be accepted only after the legal practitioner has filed an affidavit with the court which includes the following information:

- (a) the full terms of the settlement;
- (b) an estimate of the amount or other relief that may be obtained by taking the matter to trial;
- (c) an estimate of the chances of success or failure at trial;

⁶² Section 2(1) and (2).

⁶³ Section 1.

⁶⁴ Section 3 of the 1997 Act.

⁶⁵ Section 4.

- (d) an outline of the legal practitioner's fees if the matter is settled as compared to taking the matter to trial;
- (e) the reasons why the settlement is recommended;
- (f) that the matters contemplated in paragraphs (a) to (e) were explained to the client, and the steps taken to ensure that the client understands the explanation; and
- (g) that the legal practitioner was informed by the client that he or she understands and accepts the terms of the settlement.

Chapter 6

Arguments for and against conditional fees and related issues

Introduction

6.1 The virtues and vices of conditional fees as a remuneration arrangement for lawyers in civil litigation have been a matter of debate in the legal profession for some time. In this chapter we consider the various arguments for and against conditional fees, together with a number of issues which are closely related. These issues are claims intermediaries, litigants in person and the likely impact on the Bar of a conditional fee regime. We think that these issues should be borne in mind in considering any proposal to introduce conditional fees.

6.2 In identifying the case for and against conditional fees, we have considered materials from a wide range of sources, including the former UK Lord Chancellor's Department's 1989 Green Paper on Contingency Fees, the UK Department for Constitutional Affairs paper *"Conditional Fees in context – Notes on the English Experience"* (September 2004), the South African Law Commission's 1996 Report on Speculative and Contingency Fees 1996, the English Court of Appeal's judgment of *Awwad v Geraghty & Co*,¹ and the views of various commentators

Arguments against conditional fees

6.3 The literature on conditional fees identified various arguments against the introduction of conditional fees. They are: (i) the risk of conflict of interest and unprofessional conduct, (ii) increase in opportunistic and frivolous claims, (iii) excessive legal fees, (iv) reliance on legal expenses insurance and (v) satellite litigation. These arguments are discussed in turn.

The risk of conflict of interest and unprofessional conduct

6.4 Critics of conditional fees point out that a lawyer acting on the basis of a conditional fee agreement has a direct interest in the outcome of the litigation, and hence, may not be able to render impartial advice. This direct interest may further encourage him to behave in an unprofessional manner, such as by persuading his client to accept an early (and perhaps unduly low)

¹ [2003] 3 WLR 1041.

settlement in order to avoid spending the time and effort of fighting the case in court, and the risk of losing the case with the resultant loss of fees. In terms of preparation of the case, the lawyer may 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.²

6.5 The lawyer's financial interest might cause him to take charge of the litigation, disregard the wishes of his client, and use his superior knowledge to persuade the client to pursue a course of action more in line with the lawyer's interests. Although this conflict might arise in every professional-client relationship, it is especially dangerous under a conditional fee arrangement, where the client has less capacity to control the lawyer.³

6.6 Critics also point out that the public interest in the highest quality of justice outranks the private interests of the two litigants. This renders it particularly important that lawyers should not be exposed to avoidable temptations not to behave in accordance with their best traditions.⁴

6.7 It seems to us that the potential for conditional fees to create conflict of interest does raise legitimate concerns. However, this inherent danger of conditional fees is in our view insufficient, by itself, to justify the rejection of conditional fee arrangements. Rather, it seems to us that sufficient safeguards can and should be built into any system of conditional fees to minimise the disadvantages of the system and to guard against its abuse.

6.8 Take improper conduct in trial preparation as an example:- wanting success cannot be wrong in itself, provided that unfair means are not used in achieving it. Any tendency on the part of a lawyer to improve his client's case by improper techniques ought to be capable of control through professional codes of conduct, breach of which may lead to disciplinary measures against the lawyer. In addition, judges have the power to penalise practitioners personally in costs for any improper act or omission in the conduct of litigation.⁵

Increase in opportunistic and frivolous claims

6.9 Critics of conditional fees argue that the ability to sue on the basis of a conditional fee agreement would encourage the pursuit of low merit cases for nuisance value against organisations with sizeable assets. Large organisations sometimes choose to settle even unmeritorious claims to avoid the costs of litigation and bad publicity. Also, even if the large organisation can win the legal battle, costs might not be recoverable from the other side.

² Lord Chancellor's Department's Green Paper on Contingency Fees 1989, at 3.1–3.2, and South African Law Commission, *Report on Speculative and Contingency Fees* (1996), Chapter 3.

³ South African Law Commission, cited above, at 3.10.

⁴ *Awwad v Geraghty & Co* [2000] 3 WLR 1041, per Lord Justice Schiemann at 1056–1057.

⁵ Lord Chancellor's Department, cited above, at 3.3.

The increased operating costs and insurance premiums borne by those organisations would ultimately be passed on to the consumer.⁶

6.10 On the other hand, it is unrealistic to suppose that lawyers, as professional people running businesses, would willingly take on cases where there was little prospect of success. A solicitor acting on a conditional fee 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 is unlikely that the mere existence of conditional fees would lead to a significant upsurge in unfounded or “nuisance value” litigation.⁷

6.11 It has also been pointed out that retention of the costs indemnity rule would act as an effective disincentive to frivolous claims, not to mention that some form of outcome-related fee would cause lawyers to look more analytically at the merit of claims when they themselves were bearing some risk.⁸

Excessive legal fees

6.12 The problem of excessive fees is more evident in the American contingency fee system than the conditional fee system, and often results in the lawyer receiving fees disproportionate to the effort expended in a case, since the lawyer’s payment is calculated as a percentage of the amount awarded. In contrast, conditional fees are based on the lawyer’s normal fees supplemented by an uplift for taking the risk, but some argue that fees charged under the conditional fee system can be regarded as excessive if a high percentage of uplift is charged for taking a low risk.⁹ It has also been pointed out that the concept of a “normal” fee is singularly elusive anyway – some solicitors’ normal fees are a multiple of those charged by others for what on the face of it is the same work.¹⁰

6.13 Professor Zander has pointed out that there is an intrinsic conflict of interest in the method of calculating the success fee. It is in the solicitor’s interest to over-estimate the risk of the case to justify a higher success fee. A study of clients in conditional fee agreement cases showed that they did not understand conditional fee agreements sufficiently to identify this conflict. Zander believed that competition amongst lawyers was insufficiently strong to influence the level of success fees.¹¹

⁶ Lord Chancellor’s Department, cited above, at 3.3.

⁷ Lord Chancellor’s Department, cited above, at 3.11.

⁸ South African Law Commission, cited above, at 3.6.

⁹ South African Law Commission, cited above, at 3.13–3.14.

¹⁰ *Awwad v Geraghty & Co* [2000] 3 WLR 1041, per Lord Justice Schiemann at 1056–1057.

¹¹ Michael Zander, “Will the Revolution in the Funding of Civil Litigation in England eventually lead to Contingency Fees?” (Spring 2003) *De Paul Law Review* <www.lse.ac.uk/Depts/Law>.

6.14 Zander pointed out that research by Yarrow¹² showed that:

- The vast majority of completed conditional fee agreement cases (93%) were successful in the sense of achieving a settlement or a judgment wholly or partly in favour of the client. This was in contrast to solicitors' pessimism in an earlier study as to the likely success rate. A 41% average success fee would be appropriate to a case with a 70% chance of success, but in fact 93% of cases succeeded. The success fee appropriate to a case with a 93% chance of success would be only 8%.¹³
- The success fees written into the conditional fee agreement were higher than would have reflected the actual, very low, risk of losing.
- The mean success fee actually taken by solicitors (29% of costs) was lower than the mean success fee agreed in the conditional fee agreement (43% of costs). In some cases, this may have reflected the voluntary 25% cap which applied at that time to the proportion of damages which should be taken. In a few cases, the solicitor may have shared the success fee with the barrister, while in others the solicitors may not have taken the full success fee to which they were entitled.
- Nevertheless, despite this reduction, the mean success fee taken was still higher than the actual success rates would suggest was appropriate.

6.15 However, Allison Aranson has observed that, unlike the contingency fee system, the conditional fee system would not lead to excessive fees because conditional fees take into account the number of hours worked and the lawyer's hourly fees in calculating the success fee. This constitutes a check on the amount of legal fees payable, and lawyers must record the number of hours expended on the case. These records provide a basis for the court to decide on the reasonableness of the fees. Aranson stated that the conditional fee system could deter excessive fees if: (1) clients have easy access to information on lawyer's fees; and (2) there is adequate judicial scrutiny of legal costs. Aranson urged professional bodies and consumer groups to disseminate that information to help the client find the best deal.¹⁴

¹² S Yarrow, *Just Rewards* (2000). The study was based on a sample of 197 cases supplied by a representative sample of 58 solicitors' firms specialising in personal injury work. The research consisted of interviews with lawyers in 16 of the 58 firms and details of just over half of the 197 cases (56%) that were completed. Fieldwork ended in March 2000.

¹³ Note also that COOK ON COSTS 2000 states (at 468) that over 95% of personal injury, other than clinical negligence, claims succeed. It would be difficult to justify a success fee of more than 5-10% in a normal personal injury claim.

¹⁴ Allison F Aranson, *Texas International Law Journal* (Summer 1992), 27 Tex Int'l LJ 755.

Reliance on legal expenses insurance

6.16 An important element of a successful conditional fee regime is the availability of stable and affordable ATE insurance and/or BTE insurance to cover legal costs. It is readily apparent that availability of such insurance is a key factor in making the conditional fee system work.

6.17 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.¹⁵ Within three years, the scheme was in difficulties, primarily through adverse selection of cases by solicitors.

6.18 Since 1995, providers of ATE insurance have grown to around a dozen. In reality, the majority are brokers and the number of underwriters operating in the market was around five.¹⁶ However, underwriters have suffered greater losses than they had anticipated, and there is a danger that in the near future the demand for ATE insurance may not be fully met.¹⁷ If this danger materialises, it could have an adverse impact on the successful implementation of the conditional fee system.

Satellite litigation

6.19 One of the major criticisms of the English conditional fees regime is that it is unduly complex, and has led to a substantial amount of satellite litigation which is still continuing. A large part of the satellite litigation stemmed from the recoverability of success fees and ATE insurance premiums by the successful party from the defendant. This feature is, however, not essential in a conditional fee regime. In other words, one can devise a workable conditional fee system which does not permit recovery of (i) the success fee and (ii) the ATE insurance premium by the successful party.

6.20 Some of the satellite litigation has been caused by the complexity of the regulations governing conditional fees. These regulatory requirements were to some extent driven by the “unknown” nature of conditional fees and perhaps an over-zealous desire to provide comprehensive protection for the consumer.¹⁸ Instead of helping consumers, an unnecessarily complex conditional fee regime tends to achieve the opposite result, namely to frustrate and disadvantage consumers.

¹⁵ Contrast the premium of £367.50 (tax inclusive) in *Callery v Gray* in 2000.

¹⁶ M Harvey “*Guide to Conditional Fee Agreements*” Jordans 2002 at 115.

¹⁷ As above. A related issue is whether the recoverability of ATE premiums and success fees has any impact on the level of insurance premiums and the availability of ATE insurance.

¹⁸ Department for Constitutional Affairs (UK), Conditional Fees in context – Notes on the English Experience, (September 2004) at 3.

Arguments in favour of conditional fees

6.21 In the numerous jurisdictions that have allowed some form of outcome-related fees, a range of arguments have been advanced as to the advantages of outcome-related fees which apply equally to conditional fees. The arguments relevant to Hong Kong are that they will: (i) ensure access to justice, (ii) spread the financial risk involved in litigation, (iii) weed out frivolous or weak claims, (iv) allow consumers to choose and promote freedom of contract, (v) align lawyers' interests with those of the client, and (vi) harmonise the fee structure of Hong Kong with that in other jurisdictions.

Access to justice

6.22 The main advantage of conditional fees is that they may give individuals and organisations who do not qualify for legal aid but who have insufficient means to finance the full cost of litigation the opportunity of bringing their claims to court. This issue will be discussed in greater detail in the next chapter.

Spread the financial risk involved in litigation

6.23 Conditional fee agreements can partly shift the financial risk of litigation from the litigants to the lawyers and insurance companies who are in a better position to assess the chances of success, and who can spread the risk over a number of cases.

Weed out frivolous or weak claims

6.24 Conditional fee agreements can help to ensure that weak or frivolous claims are not brought, because lawyers would not earn any fees from running hopeless cases.¹⁹ Under a conventional fee agreement, an unscrupulous lawyer could mount a frivolous claim 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.

Allow consumers to choose and promote freedom of contract

6.25 Removing the ban on conditional fees would enable the client who had a cause of action to seek out the most advantageous agreement. The introduction of conditional fees would provide clients with greater choice.

¹⁹ Department for Constitutional Affairs, cited above, at 2.

Not only could the client compare the fee levels of different firms, but also the relative costs of conditional or conventional fee arrangements.²⁰

6.26 As long as conditional fees are suggested as an alternative to, but not as a replacement for, the conventional basis of charging, lawyers and clients are allowed greater freedom of contract. Neither party is obliged to adopt a conditional fee arrangement against their wishes.²¹ It could be said, however, that parties to a contract must have equal bargaining power for there to be true freedom of contract. Given his professional training and experience, the lawyer's bargaining power might be superior to that of his client. This would, however, appear not to be an argument against conditional fee agreements, but an argument that conditional fee agreements should be regulated appropriately. There is a contrary view, namely, that with the introduction of conditional fees, large corporations with superior bargaining powers could, in effect, force a lawyer to take on a case on a conditional fees basis (and if the lawyer is unwilling to do so, the large corporation would just "turn elsewhere"). We have, however, not seen any evidence that this has been a problem in jurisdictions which have introduced a conditional fees regime.

Align the lawyer's interests with those of the client

6.27 Proponents of conditional fees point out that conditional fees align the lawyer's interests with those of the client. It might be said that clients would prefer their lawyers to be interested in the outcome of litigation and to display greater diligence and commitment to the case. In the present system, where the lawyer is paid irrespective of outcome, the lawyer might have less incentive to pursue the matter diligently or expeditiously.²² Conditional fees would encourage a greater level of commitment and efficiency on the part of the lawyer, who would have a stake in the outcome of the proceedings.

6.28 To such proponents, 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 (or where the client's financial ability to pay his lawyer's fees depends on his success in the very case in question), 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.

²⁰ Lord Chancellor's Department, cited above, at 3.13–3.15.

²¹ South African Law Commission, cited above, at 3.15–3.17.

²² South African Law Commission, cited above, at 3.8–3.12.

Harmonise the fee structure with other jurisdictions

6.29 Many jurisdictions allow some form of outcome-related fee, including the United States, England, Scotland, Ireland, the Australian jurisdictions, the Canadian jurisdictions, and the Mainland. At present, the Supplementary Legal Aid Scheme in Hong Kong operates on an outcome-related fee basis. However, the scope of the Scheme is limited, with only about 100-200 cases a year. The introduction of conditional fees in Hong Kong would harmonise Hong Kong lawyers' fee structure with those of other jurisdictions.

Other related issues

Claims intermediaries

6.30 We now turn to consider three related issues, namely, claims intermediaries, litigants in person and the likely impact on the Bar of a conditional fees regime.

6.31 In England, since the abolition of criminal and civil liability for champerty and maintenance, claims intermediaries (also referred to as recovery agents, compensation claims agents, claims management companies or claim farmers) have proliferated. Concern over the activities of claims intermediaries has been a constant theme in England 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. There are concerns at the way in which some intermediaries obtained their business, and the suitability of ATE insurance and loan products sold to claimants.

6.32 The views collected by the UK Department for Constitutional Affairs in response to its consultation exercise in 2003²³ identified a number of problems which have emerged in the claims intermediaries sector:

"Many respondents expressed grave concerns over the behaviour and conduct of claims intermediaries in marketing and selling their products. Unlike solicitors, who are bound by a professional code of conduct, claims intermediaries are unregulated. However, the respondents also recognised the important role that intermediaries have in informing consumers of their legal rights. The respondents suggested that regulations

²³

DCA, *Consultation Paper on Simplifying CFAs*, June 2003.

should be considered to control the activities of these intermediaries.

The Law Society believed that it was crucial that the claims management industry be subject to regulation if they were to be involved in the provision of advice under CFAs. Citizens Advice suggested that primary legislation be introduced to bring claims intermediaries within the scope of legal services regulation. The Federation of Small Business (FSB) stated that CFAs had encouraged the emergence of claims farmers who derive their income from persuading clients to make a claim without any real investment in the merits of the action. The FSB also felt that claims were now more complex, with each claim being broken down so that every small detail is priced. This has increased the costs of claims. The FSB would like to see a simpler system for making claims, and proposed that some restrictions should be placed on the various types of claim made under CFAs.”

Regulation of claims intermediaries in England

6.33 There is some existing regulation of aspects of the services that claims intermediaries offer to the public. For example, the Law Society and the Bar Council regulate the conduct of solicitors and barristers respectively who work with, or take work from, these companies. Their activities may be covered by trading standards legislation, including the supply of goods and services, unfair contract terms and trade descriptions. Their advertisements are under the purview of the Advertising Standards Authority and the Office for Communications. There is, however, no sector-specific regulation.

6.34 In 2003 and 2004, the sudden collapse of several claims intermediaries gave rise to concerns from consumers and solicitors. At present, claims intermediaries in England may join the Claims Standards Council on a voluntary basis. But only a small proportion have opted to do so. In November 2004, the UK Government proposed that the Claims Standards Council should work vigorously towards approval of its code of practice by the Office of Fair Trading, with the hope that the code of practice would raise the standards of claims intermediaries. 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.²⁴

6.35 This resulted in the enactment of the Compensation Act 2006 which makes provision for the regulation of claims management companies. If a person is to provide “regulated claims management services” he has to be either:

²⁴

For an earlier review, see The Blackwell Report published in April 2000.

- authorised by the Regulator in accordance with section 5, or
- an exempt person, or the requirement for authorisation has been waived in relation to him in accordance with regulations under section 9, or
- an individual acting otherwise than in the course of a business.

6.36 Claims management services means “*advice or other services in relation to the making of a claim*”, and “*claim*” is defined to mean:

“a claim for compensation, restitution, repayment or any other remedy or relief in respect of loss or damage or in respect of an obligation, whether the claim is made or could be made –

- (i) by way of legal proceedings,*
- (ii) in accordance with a scheme of regulation (whether voluntary or compulsory), or*
- (iii) in pursuance of a voluntary undertaking.”²⁵*

6.37 However, it seems not all claims management services are regulated; they are regulated if they are –

- “(i) of a kind prescribed by order of the Secretary of State, or*
- (ii) provided in cases or circumstances of a kind prescribed by order of the Secretary of State.”²⁶*

Operation of claims intermediaries in Hong Kong

6.38 There are indications that claims intermediaries are becoming more active in Hong Kong. Some lawyers have expressed the view to us that claims intermediaries are mostly interested in maximising their profits within the shortest time. These lawyers assert that claims intermediaries often take on high value cases with a good prospect of success and then charge 20%-30% of the compensation recovered. The claimants could have paid much less, the lawyers say, had they employed the services of a qualified lawyer. However, members of the public seem to be attracted by the additional services which claims intermediaries offer, such as providing escort service to medical examination and advancing loans to the claimant during the pre-trial period.

6.39 The fact that claims intermediaries are not currently subject to regulation could be a cause for concern. Other concerns relating to claims intermediaries include:

²⁵ Section 4(2)(c).

²⁶ Section 4(2)(e).

- (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 the basis of 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.²⁷
- (vi) If the case is lost and the claims intermediary 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.

Information revealed at Legislative Council's Panel on Administration of Justice and Legal Services

6.40 The issue of claims intermediaries has been the subject of discussion at the Legislative Council's Panel on Administration of Justice and Legal Services ("AJLS Panel") for some time. From the information available,²⁸ it appears that claims intermediaries have engaged in serious touting in the vicinity of the offices of the Labour Department, the Social Welfare Department (Traffic Accident Victims Assistance (TAVA) Section), the Legal Aid Department and at public hospitals. Claims intermediaries would loiter in the lift lobbies or reception areas of the relevant offices and approach applicants involved in labour disputes, applicants for legal aid, or victims of traffic accidents or their family members to solicit business.

6.41 As it was known that some solicitors may be involved in, or connected with, the activities of claims intermediaries, it was suggested that the Law Society should investigate and take appropriate disciplinary

²⁷ The time-costs payable by a claimant with a strong case involving the award of substantial damages, may be considerably less than the 20%-30% contingency charges payable to claims intermediaries.

²⁸ Paper submitted by Department of Justice to the Panel dated February 2006.

proceedings against the law firms and/or solicitors who were involved in, or connected with, the operation of claims intermediaries.²⁹

Relevant regulations and rules

6.42 We noted earlier in this report³⁰ that a solicitor may not enter into a conditional or contingency fee arrangement to act in contentious business. That restriction stems from legislation, conduct rules and the common law offences of champerty and maintenance. Therefore, if a legal practitioner uses a claims intermediary company as a facade to charge contingency fees, he may be guilty of the common law offence and may have contravened relevant legislation and professional conduct rules.

6.43 If a solicitor or barrister accepts referrals from claims intermediaries, and in return offers kickbacks or shares profits with the intermediary, that may amount to a breach of rule 4 of the Solicitors' Practice Rules (which prohibits the sharing of fees with non-qualified persons) or paragraph 92 of the Bar Code (which prohibits a barrister from giving a commission or present to any person who introduces work to him).

6.44 Persons other than solicitors and barristers, depending on the facts of the case, may be caught under the Legal Practitioners Ordinance (Cap 159), which makes it an offence for a person to practise as a barrister or notary public, or to act as a solicitor, if he is not qualified to do so. There are also offences in respect of unqualified persons who prepare certain documents relating to the commencement and conduct of proceedings.³¹

6.45 Unqualified persons may, depending on the facts of the case, be guilty of the common law offence of maintenance and champerty. Maintenance may be defined as the giving of assistance or encouragement to one of the parties to litigation by a person who has neither an interest in the litigation nor any other motive recognised by the law as justifying his interference. Champerty is a particular kind of maintenance, namely, maintenance of an action in consideration of a promise to give the maintainer a share in the proceeds or subject matter of the action.

6.46 In April 2005, a Special Committee of the Bar Association issued a report on recovery agents. Recovery agents are defined in the report as companies which purport to assist victims of personal injuries arising from, primarily, work related accidents, traffic accidents and medical procedures to pursue their claims for compensation in return for a fee as a percentage of the recovered damages (usually ranging from 20% to 25%). The payment of this percentage is usually made directly to the recovery agents by the victim's solicitor, who is specifically authorised (in the contract made between the

²⁹ As above.

³⁰ Chapter 1.

³¹ Also in respect of some documents on conveyancing and the administration of a deceased person's property.

victim and the recovery agent) for this purpose.³² It is common for recovery agents to hold themselves out to victims as professionals having expertise in making personal injury claims.

6.47 Recovery agents operate for profits and under the pledge of “no win, no pay”, ie, the client will only be liable to pay a fee if his claim is successful. The Bar Association’s report observed that the customer contracts used by recovery agents are neither well-drafted nor customer-oriented, and some of them are opaque as to the scope of responsibility of the recovery agents. Sometimes, the contracts do not specify who has responsibility for the defendants’ costs in the event that the action fails.

6.48 Given that maintenance and champerty are both tortious and common law offences, the report by the Bar Association’s Special Committee concluded that:

- (i) The agreements between recovery agents and their customers are champertous and constitute a crime in Hong Kong;
- (ii) Such agreements cannot be enforced in a civil court in Hong Kong;
- (iii) Lawyers who knowingly assist in the performance of champertous agreements are themselves liable to be prosecuted as accessories to the criminal offence;
- (iv) Lawyers who have agreed to contingency fees in the context of litigation may have committed the crime of champerty;
- (v) Such lawyers are answerable for the breach of their professional codes of conduct;
- (vi) Given the prevalence of recovery agents, the Bar Council may see fit to consider whether these matters should be brought to the attention of the Department of Justice.

6.49 As for the Law Society of Hong Kong, it issued a circular to its members on 17 May 2005, advising them that the practice of claims intermediaries is a criminal offence in Hong Kong, and lawyers risked committing professional misconduct if they worked on cases financed by claims intermediaries.

The Administration’s policy on claims intermediaries

6.50 In its paper to the Legislative Council Panel on Administration of Justice and Legal Services in March 2006, the Administration explained its

³² See para 2.17 of the Report from the Special Committee on Recovery Agent.

position regarding claims intermediaries and stated that it has adopted a three-pronged approach – involving public education, possible prosecution, and consideration of the need for legislation.

6.51 On public education, the Department of Justice has arrangements with the Labour Department (through the Employees' Compensation Division and Occupational Medicine Division), the Department of Social Welfare (through the Traffic Accident Victims Assistance Section), the Legal Aid Department and the Hospital Authority to take steps including:

- Distributing leaflets to injured employees, applicants for assistance, and the general public.
- Displaying cautionary messages in digital display panels and on posters.
- Instructing security guards to stop claims intermediaries from touting on Government premises and to evict relevant persons.

6.52 With regard to possible prosecution, the Law Society has supplied the Department of Justice with information concerning advertisements on the internet and in the local media relating to a number of claims intermediaries. The Police are conducting investigations of certain suspected cases, and if evidence of illegal activities is uncovered, the Department of Justice will consider bringing prosecutions.

6.53 As for the need of legislation, there was a general understanding that it would be more appropriate to see whether prosecution based on the existing law could regulate the activities of claims intermediaries before considering any legislative measures.

The impact of allowing legal practitioners to charge conditional fees on claims intermediaries

6.54 If legal practitioners in Hong Kong are allowed to charge outcome-related fees (whether or not in the Conditional Legal Aid Fund environment as proposed in the recommendations set out in the next chapter), those changes are likely to impact on claims intermediaries. On the one hand, legal practitioners will become more price-competitive, which would be likely to take away business from the claims intermediaries and bring such business to lawyers, who will be properly regulated by their professional bodies. On the other hand, if the common law offences of maintenance and champerty are abolished, claims intermediaries may employ more aggressive marketing techniques to enhance their share of the litigation market, as has been the case in England. There is, however, very little material on which to base an assessment of what the impact is likely to be.

Litigants in person

6.55 There is no doubt that litigants in person have become a major feature of the litigation landscape in Hong Kong, and this increase in litigants in person is one of the major problems confronting the civil justice system in Hong Kong.

Some statistics on litigants in person

6.56 Below are statistics at Master's Hearings, Trials and Appeals in the High Court:

	No. of contested proceedings involving unrepresented litigant(s) ^{Note 1} / Total no. of proceedings (%)					
Nature of proceedings	2001	2002	2003	2004	2005	2006
(a) Hearings before Master ^{Note 2}	491/1445 (34%)	445/1332 (33%)	360/1048 (34%)	371/1035 (36%)	331/869 (38%)	310/945 (33%)
(b) Civil appeals handled by CFI (including appeals against Master's decision)	203/448 (45%)	244/462 (53%)	318/526 (61%)	259/443 (59%)	250/435 (57%)	160/328 (49%)
(c) Trials in CFI ^{Note 3}						
overall	131/402 (33%)	132/430 (31%)	142/433 (33%)	106/385 (28%)	119/402 (30%)	121/411 (29%)
(HCA, HCPI and HCMP)	115/339 (40%)	123/386 (32%)	106/327 (32%)	85/312 (27%)	80/298 (27%)	74/276 (27%)
(Bankruptcy cases)	0/5 (0%)	1/1 (100%)	2/5 (40%)	2/3 (67%)	9/12 (75%)	14/15 (93%)
(Matrimonial cases)	2/2 (100%)	0/4 (0%)	0/1 (0%)	0/0 (n/a)	0/1 (0%)	1/1 (100%)
(Other civils) ^{Note 4}	14/56 (25%)	8/39 (21%)	34/100 (34%)	19/70 (27%)	30/91 (33%)	32/119 (27%)
(d) Civil appeals to Court of Appeal	21/120 (18%)	106/231 (46%)	64/203 (32%)	72/211 (34%)	90/276 (33%)	97/282 (34%)
Trials/Appeals All CA & CFI civils	355/970 (37%)	482/1123 Note 5 (43%)	524/1162 (45%)	437/1039 (42%)	459/1113 (41%)	378/1021 (37%)

Note 1 "Proceedings involving unrepresented litigants" means those in which at least one party is unrepresented.

Note 2 "Hearings before Master" covers all Chambers and Court hearings before Masters where the estimated length is 1 hour or above.

Note 3 “Trials” includes (i) trials of actions begun by writ and (ii) substantive hearings lasting more than one day in respect of proceedings begun otherwise than by writ, which are concerned with a final determination of the proceedings. The statistics only show the position at the commencement of trial/ substantive hearing.

Note 4 “Other civils” refers to Admiralty Actions, Commercial Actions, Companies Winding Up Proceedings, Constitutional & Administrative Law Proceedings, Construction & Arbitration Proceedings, Probate Actions, Adoption Applications, Applications for Interim Order (Bankruptcy), Applications to set aside a statutory demand, Caveat Applications and Applications for grant.

Note 5 If CA hearings on right of abode cases in 2002 are taken into account, the total figures would be 6383/7032 (91%)

6.57 As the statistics collated by the courts are mainly concerned with unrepresented cases which have an impact on judicial resources, the statistics for trials in the Court of First Instance only captured either contested trials or substantive hearings lasting more than one day in respect of proceedings begun otherwise than by writ, which are concerned with a final determination of the proceedings. It can be seen from the table above that for hearings before a Master (which include all Chambers and Court hearings before Masters with an estimated length of one hour or more), the percentage of hearings involving at least one unrepresented party has remained relatively stable: in 2001, the figure was 34%, and in 2006, the figure was 33%. As for civil appeals handled by the Court of First Instance, the percentage rose from the already high 45% in 2001 to 61% in 2003. Since 2003, however, there has been a downward trend, and in 2006, the figure stood at 49%. For trials in the Court of First Instance, the overall percentage of litigants in person dropped slightly from 33% in 2001 to 29% in 2006. The percentage for civil appeals to the Court of Appeal rose markedly, from 18% in 2001 to 34% in 2006. In absolute numbers, the figures increased more than four-fold, from 21 hearings to 97 hearings.

6.58 Below are statistics for contested civil trials in the District Court involving litigants in person:

Nature of proceedings	No. of contested proceedings involving unrepresented litigant(s) ^{Note 1} / Total no. of proceedings (%)					
	2001	2002	2003	2004	2005	2006
(a) Civil Actions (non-IRD)	115/228 (50%)	97/227 (43%)	111/250 (44%)	102/211 (48%)	127/217 (59%)	161/289 (56%)
(b) Personal Injuries Actions	4/12 (33%)	15/27 (56%)	12/23 (52%)	10/36 (28%)	14/46 (30%)	18/69 (26%)

	No. of contested proceedings involving unrepresented litigant(s) ^{Note 1} / Total no. of proceedings (%)					
Nature of proceedings	2001	2002	2003	2004	2005	2006
(c) Miscellaneous Proceedings	2/3 (67%)	2/3 (67%)	1/3 (33%)	6/8 (75%)	2/3 (67%)	4/6 (67%)
(d) Other civils ^{Note 2}	22/57 (39%)	53/86 (62%)	38/71 (54%)	48/82 (59%)	31/58 (53%)	33/55 (60%)
Trials ^{Note 3} All DC civils	143/300 (48%)	167/343 (49%)	162/347 (47%)	166/337 (49%)	174/324 (54%)	216/419 (52%)

Note 1 “Proceedings involving unrepresented litigants” means those in which at least one party is unrepresented.

Note 2 “Other civils” refers to Distraint Cases, Estate Agents Appeals, Employees’ Compensation Cases, Equal Opportunity Cases, Miscellaneous Appeals, Occupational Deafness (Compensation) Appeals, Pneumoconiosis (Compensation) Appeals and Stamp Appeals.

Note 3 “Trials” includes trials of actions begun by writ, but does NOT include substantive hearings begun otherwise than by writ or hearings before Masters. The statistics only show the position at the commencement of trial.

6.59 It can be seen from the table above that the percentage of contested civil trials in the District Court involving litigants in person remained at about 48% to 49% between the years 2001 and 2004. The figure rose to 54% and 52% in 2005 and 2006 respectively.

Why litigants in person do not obtain legal representation

6.60 A paper entitled “Response to the Consultation Paper of the Law Reform Commission on Conditional Fees” prepared by the Law Society’s Working Party on Conditional Fees referred³³ to a survey conducted by the Steering Committee on Resource Centre for Unrepresented Litigants in 2002. A total of 632 responses were received of which 54% were litigants in person. The litigants in person gave the following reasons for not obtaining legal representation:

- Cannot afford to engage lawyers 63%
- It is not necessary to engage lawyers 30%

³³

At para 2.4.

- Other reasons: lack of trust of lawyers or legal representation not allowed by legislation 7%

6.61 The Law Society Working Party also highlighted the survey's finding that "33.8% of the litigants in person were involved in bankruptcy claims", and that "more than 75% of the litigants in person were unaware of the Duty Lawyer Service Free Legal Advice Scheme or the Bar Association's Free Legal Service Scheme."³⁴ It should be noted, however, that the Duty Lawyer Service Free Legal Advice Scheme is only advisory in nature, and that the Bar Association's Free Legal Service Scheme (often referred to as the Pro Bono Scheme) has very few cases that led to actual representation in court.

6.62 The Law Society Working Party also referred to some legal aid statistics:

*"out of the 22,206 applications for legal aid in 2004, 6,810 applicants (30.7%) for civil legal were refused. Of these applications, 6,036 (27.2%) were refused on ground of merits; 774 (3.5%) were refused on ground of means. The majority of those rejected on merits involved matrimonial disputes."*³⁵

The Working Party went on to say that for:

*"litigants whose applications for legal aid have been rejected on ground of merits; for the vexatious litigants or serial appellants who have an unmeritorious claim, and for defendants who choose to alternate between self and legal representation as a tactical move in litigation, it is arguable that conditional fees may not alter their position."*³⁶

6.63 It is our view that the discrepancy between the figures 27.2% (refused on merits) and 3.5% (refused on means) should not be taken to mean that unmeritorious litigants are more prevalent than those with good grounds. The increased publicity given to legal aid eligibility limits through the Legal Aid Department's webpage, tele-messages and printed leaflets may have lead some people with a meritorious case to decide not to apply for legal aid if they calculate they have net disposable means over and above the limits.

6.64 The 2002 survey³⁷ figures quoted by the Working Party found that 33.8% of litigants in person were involved in bankruptcy cases. However, according to the figures from the Judiciary, the figures especially in terms of absolute numbers were low although it should be noted the figures captured do not include self-petitioned bankruptcy cases that were uncontested, or if contested, were disposed of in short hearings.³⁸

³⁴ At para 2.4.

³⁵ At para 2.3.

³⁶ At para 2.7.

³⁷ Conducted by the Steering Committee on Resource Centre for Unrepresented Litigants. See discussion above.

³⁸ See para 6.57 for counting rules.

6.65 We are of the view that some form of outcome-related fees would help litigants in person. Although it is true that not all of them have well-founded cases, at least a portion of the litigants in person deserve better assistance, especially given:

- Some types of claims are not covered by the legal aid schemes; for example, shareholders' claims, claims by limited companies, and defamation.
- Some litigants alternate between self and legal representation not because they use it as a tactical ploy (to gain "sympathy" of the court or to delay the matter), but because they do not have sufficient funds to afford legal representation for the whole litigation process.
- Legal representation is not allowed before the Small Claims Tribunal and the Labour Tribunals, but that prohibition does not apply to appeals from those tribunals. Where the case involves an individual litigant of limited means against a well-funded opponent, outcome-related fees would help ensure that there was legal representation for both sides at any appeal hearing.

6.66 If a portion of the litigants in person can enjoy some form of legal representation, benefits will accrue not only to themselves (through enhanced access to justice), but also to the judicial process as well as to other parties in the proceedings. It is likely that even the most thorough of research cannot delineate with precision what percentage of litigants in person (i) has a meritorious case and (ii) has chosen to self represent chiefly due to financial constraints (and it is essentially this group of persons who would benefit the most from conditional fees). However, as a matter of common sense, amongst the litigants in person using the judicial system everyday, there are bound to be some with a good case who have chosen to act in person because of lack of means. Providing increased opportunities for legal representation though some form of outcome-related fees is likely to benefit at least some litigants in person.

6.67 The prevalence of unrepresented litigants puts pressure on the civil justice system in Hong Kong, especially on the court's bilingual facilities, since the vast majority of unrepresented litigants would wish the proceedings to be conducted in Chinese. Although various measures can be developed to meet the needs of unrepresented litigants, the most direct response is to secure legal representation for them.

Other surveys – Litigants in Person Project

6.68 Self-representation in civil proceedings is the subject of a research project entitled "Investigation and Analysis of Issues Raised by Self-Representation in the High Court of Hong Kong". The initiative is known

as “The Litigants in Person Project” and is headed by Professor Elsa Kelly,³⁹ who very kindly agreed to include a question on conditional fees in that project’s questionnaire.⁴⁰

6.69 The litigants in person interviewed⁴¹ were asked whether they had applied for legal aid: 50.6% had applied and 49.4% had not. Of the 50.6% who had applied, 88.1% had had their application rejected.

6.70 Respondents were then asked whether they would instruct a solicitor if they were offered the following fee options:

Option 1 : “No Win, no Pay”	Yes : 88.9%	No : 3.7%	Don’t know : 2.5%
Option 2 : “If you lose, you pay your lawyer a lower fee than normal”	Yes : 51.3%	No : 17.5%	Don’t know : 25%
Option 3 : “If you win, you pay your solicitor a higher fee than normal”	Yes : 58%	No : 13.6%	Don’t know : 23.5%

6.71 It should be noted that the three options were not mutually exclusive; in fact, Options 1 and 3, and Options 2 and 3, are different aspects of the same package, and the findings⁴² and percentages of support or otherwise should be read taking this fact into account. It may be that by the time the respondents gave their answers to the third option they had a fuller picture of the effect of conditional fees (through the process of “thinking” and giving answers to the first two options) and it could be argued that the breakdown of responses to Option 3 provides a more accurate reflection of the popularity of conditional fees amongst the litigants in person who were interviewed. Subject to these caveats, it can be said that well over half of the respondents in the survey supported conditional fees, while only 13.6% were

³⁹ Associate Professor, The Chinese University of Hong Kong. Other team members are Dr CHUI Wing Hong, Senior Lecturer, The University of Queensland, and WONG Hing Yee, Research Assistant, The Chinese University of Hong Kong.

⁴⁰ The information in this part is extracted from the *Litigants in Person Project – Report on Conditional Fees* that is fully supported by a grant from the Research Grants Council of the HKSAR for the Project entitled “Investigation and Analysis of Issues Raised by Self-Representation in the High Court of Hong Kong” (Project No. CUHK 1191/04H (2004)[law].

⁴¹ Site interviews were successfully conducted with 81 litigants in person in the High Court of Hong Kong (in civil actions) between 6th March and 30th June 2006. Given the time and resource constraints, the study adopted a non-probability sampling strategy (ie purposive sampling) and the findings are subject to further verification.

⁴² Findings of the survey: “The response to the question concerning the implementation of conditional fee arrangements was mixed. Clearly, most of the litigants in person who participated in the exit interviews favoured the first option, „no win, no pay“. Slightly over half of them favoured the other two options. However, the comments from respondents (made in respect of the three options and generally), and the number of „don’t know“ responses, suggest that if conditional fee arrangements are to become a feature of Hong Kong’s legal landscape, resources might be needed to fund public education initiatives in order to ensure that the concepts are fully understood. Further research would be advisable to test whether the findings contained in this report would be replicated when using a larger, representative sampling method.”

opposed to the idea. As for the 23.5% who were unsure, we believe this figure is understandable given the novelty in Hong Kong of concept of conditional fees.

Earlier research by Camille Cameron⁴³ and Elsa Kelly⁴⁴

6.72 Between 2002 and 2005, Cameron and Kelly conducted research and published a series of articles on litigants in person in civil proceedings.⁴⁵ Relevant material from those articles is extracted below:

- (a) *“Litigants in person are increasing in numbers in courts of all levels in common law jurisdictions. Most of our knowledge is based on qualitative or anecdotal information. ...*

It would then be essential to go beyond this profile to a consideration of the relationship between the merits of their cases and the outcomes. As stated in this article, there is sufficient evidence to justify the hypothesis that litigants in person do not do as well as represented parties. This proposition has not yet been tested empirically in the specific context of litigants in person in civil proceedings.”⁴⁶

- (b) **Categories of litigants in person**

“Although ‘litigants in person’ is a convenient description, it is misleading to over-generalise, as the individual needs of such litigants vary. Orthodox thinking has it that a litigant in person is someone who cannot afford to hire a lawyer. But there may be distinctions, for example those who are eligible for legal aid but have been refused it; those who are eligible for legal aid but have not applied for it, possibly because they are ignorant of its availability; and those who are not eligible for legal aid or supplementary legal aid but do not have sufficient funds to pay for legal representation (sometimes referred to as ‘the sandwich class’).

Some people probably choose to represent themselves. There is as yet very little empirical or even anecdotal support for this supposition. ...

There is probably another category of litigants in person – those who represent themselves because no lawyer will represent them. At the extreme end of this spectrum are those in the ‘vexatious litigant’ category, who pursue hopeless cases or

⁴³ Associate Professor, Faculty of Law, University of Melbourne.

⁴⁴ Associate Professor, School of Law, The Chinese University of HK. (previously Assistant Professor, School of Law City University of HK)

⁴⁵ Hong Kong Law Journal 32 HKLJ 313 [2002]; 33 HKLJ 585 [2003]; and HKLJ 585 [2005].

⁴⁶ 32 HKLJ 313, at 341.

litigate for reasons unconnected with vindicating legal rights. There is no empirical evidence to tell us how much of the entire pool of litigants in person consists of vexatious litigants. However, the identifiable trend over time in the cases and other literature on the topic is that this is a small, and declining, portion of the entire pool of litigants in person.”⁴⁷

(c) **Why do litigants represent themselves?**

“... Most of the available information is anecdotal and comes not from litigants in person, but from other stakeholders in the system, including judges, lawyers, legal aid officials and court staff. There is a need for research that deals specifically with the reasons why people choose or are forced to represent themselves.

Notwithstanding these limitations, there is considerable support in some jurisdictions for the conclusion that changes in the availability of legal aid assistance are partly responsible for the increase in litigants in person. Dewar and his co-authors concluded in their qualitative study of the impact of changes to legal aid in Queensland:

„... There is no doubt that changes to legal aid have been the most significant contributory factor in this increase [in litigants in person]. This in turn can be attributed to:

- Tighter guidelines, which means that some matters are effectively not funded (for example, family property matters) and which the party cannot afford to fund themselves; and*
- Capping, which means that a grant of aid may simply run out before proceedings are concluded, and the party cannot afford to continue except in person.”*

It cannot be assumed that these findings would be replicated in Hong Kong or other jurisdictions, but the Queensland findings point the way to research that needs to be conducted. That research should include the following questions: the percentage of litigants in person who applied for legal aid, and if they did not, the reasons why; whether they had legal aid for certain stages of the litigation only; and if so how they compare their experience with legal aid representation to their experience representing themselves.”⁴⁸

⁴⁷ 32 HKLJ 313 at 318, 319.

⁴⁸ 32 HKLJ 313 at 328, 329.

- (d) Following the publication of Part I of their article, Cameron and Kelly conducted a survey of the solicitors' profession based on solicitors' perceptions of the issues. They found there were 5,173 solicitors practising in Hong Kong, of which the Law Society estimated that no more than 1,200 were "full-time" litigators. The number of "part-time" litigators who practised also in other fields of law could not be estimated with any degree of accuracy. 4,607 questionnaires were posted and 711 questionnaires were returned. Of the 711 replies, 403 completed the full questionnaire, while 306 answered only the attitudinal questions.⁴⁹

(e) **Meritorious and unmeritorious claims**

"Related to the idea of separate „tracts" to deal with cases that differ in value and complexity, is the need to distinguish between meritorious and unmeritorious claims. While there was no predominant view in the survey responses as a whole that most claims and defences advanced by self-represented litigants are unmeritorious or vexatious, some respondents did express strong views on the need to deal firmly with unmeritorious cases:

„In my experience, "crazy" or "irrational" litigants are wasting a huge amount of court time and costs. Genuine lay litigants should be accommodated. But extreme "crazy" litigants have to be dealt with more firmly than they are at present".

„Most cases are of no merit, making the cases a total waste of the other party's time and money. And those litigants refuse to pay the costs. So security for costs is necessary (or other protection)".

„The courts are being clogged by cases with unrepresented litigants whose claims or defences are wholly or in part hopeless".⁵⁰

(f) **Legal aid**

"Among the reforms proposed was increasing the availability of legal aid funding. One respondent highlighted the problem that legal aid funds are not available for certain types of cases:

„It is not proper to give advice on merits of their case when they are an opponent. But without [that] knowledge, they usually act unreasonably when negotiating settlement. Legal Aid does not usually help people in IP (intellectual property) disputes".

⁴⁹ 33 HKLJ 585 at 586.

⁵⁰ 33 HKLJ 585 at 604, 605.

*„Review of legal aid system, relaxing the means test“
„On the one hand, to expand the service of Legal Aid Department so that more litigants [would] be eligible. On the other hand, to provide institutional advice or assistance to those not available for legal aid“.*⁵¹

- (g) *“The survey included two specific questions about the disadvantages of self-representation. Firstly, solicitors were asked to indicate whether, in their experience, self-represented litigants were disadvantaged and if so, the extent of that disadvantage. Of the respondents, 10.5 per cent thought that self-represented litigants were not disadvantaged at all and 20.9 per cent thought that there was a disadvantage but that it was not great. A majority of 62.3 per cent indicated that the disadvantage was great or very great.*

The purpose of the second question regarding the perceived disadvantages faced by self-represented litigants was identification. From a menu of disadvantages, solicitors identified the following disadvantages:

- no knowledge of the formal rules of court (21.3 per cent)*
- no knowledge of substantive law (22.2 per cent)*
- inability to present merits of their case (20.1 per cent)*
- inability to negotiate a settlement (12.7 per cent)*
- no knowledge of court administration procedure (11 per cent)*
- no understanding of court etiquette (9.1 per cent).*⁵²

(h) **Effect of self-representation of case outcome**

*“Solicitors were asked whether they believed that lack of representation affected case outcome for self-represented litigants. Of the respondents, 66.4 per cent stated that self-representation sometimes had an adverse affect on case outcome and another 15.9 per cent stated that it always did.”*⁵³

Australian Law Reform Commission

6.73 The Australian Law Reform Commission (“the ALRC”) has researched the issue of unrepresented litigants, and published a Background Paper in 1996. The ALRC found that:

“While some people may choose to represent themselves in court, it is likely that many litigants in person are without legal

⁵¹ 33 HKLJ 585 at 605, 606.

⁵² 33 HKLJ 585 at 588, 589.

⁵³ 33 HKLJ 585 at 592.

*representation because they cannot afford it and do not qualify for legal aid. A close relationship can be expected between the number of litigants in person and the extent to which people are able to obtain civil legal aid or other legal assistance through pro bono schemes, access to speculative and contingency fee arrangements and other forms of legal and litigation assistance.*⁵⁴

6.74 When assessing the impact of unrepresented parties on proceedings, a distinction must be drawn between complex and routine matters. For routine matters, such as those usually dealt with by tribunals, it is generally agreed that substantial savings in legal costs can be achieved by limiting or forbidding legal representation. For complex matters, however, the lack of professional representation can constitute a serious burden for all concerned.

6.75 Litigants in person may impact adversely on the costs of other parties and on the time taken to complete proceedings. The cost to represented litigants when they are faced with an unrepresented litigant may be increased by:

- more time being spent in directions hearings, motions and hearings;
- more costs being incurred in responding to the broad-brush evidence that may be relied on by unrepresented litigants;
- a reduction in trial certainty and an inability to advise properly as to probable costs; and
- increased costs incurred as a result of poor issue definition and clarification.⁵⁵

6.76 Litigants in person are a problem for the adversarial system of litigation, premised as it is on two equally matched sides able to present their respective cases with skill and in full.⁵⁶ Lord Woolf has commented that the judge should ensure that the unrepresented party gets a fair hearing and understands the outcome of the case. He has recommended that judges should be prepared to adopt an interventionist approach and the handling of such cases should be incorporated in judicial training.⁵⁷

6.77 However, there are limits on how far a judge can depart from the traditional detached role in the adversarial system to render assistance to the unrepresented litigant. In fact, Lord Devlin has commented that where there is no legal representation, and save in the exceptional case of the skilled litigant, the adversarial system, whether or not it remains in theory, in practice

⁵⁴ Australian Law Reform Commission, *Background Paper on the Unrepresented Party*, December 1996, Chapter 3.

⁵⁵ ALRC, cited above.

⁵⁶ Professor R Cranstone, *Access to Justice Background Report for Lord Woolf's Inquiry*, Lord Chancellor's Department London 1995, 151. Cited in ALRC, cited above.

⁵⁷ Lord Woolf, *Access to Justice; Interim Report to the Lord Chancellor on the Civil Justice System in England and Wales*, 1995, 135. Cited in ALRC, cited above.

breaks down.⁵⁸ Professor Cranston has commented that, if only in the interests of efficiency, some assistance must be given to the litigant in person, given the burdens such litigants impose and the more extended hearings which can result.⁵⁹

Consumer Council's Consumer Legal Action Fund

6.78 It is clear that some persons with meritorious cases in Hong Kong are unable to finance their litigation. The Consumer Council's Consumer Legal Action Fund ("the CLA Fund")⁶⁰ provides figures on this.

6.79 From 30 November 1994 to 15 June 2006, the CLA Fund considered 85 groups of cases involving multiple claimants. They managed to take up 29 groups of cases which involved 649 claimants.

6.80 The remaining 56 groups of cases were either declined or referred to the Consumer Council for other forms of follow-up action. Even amongst these 56 groups of cases, 20 groups of cases were with merits but were declined due to the lack of demonstrative effect. According to the Consumer Council, the aggregate number of potential claimants involved in the "with merits" groups would be between about 140⁶¹ and several hundred. A breakdown of these 20 groups of cases is as follows:

Type	Case No.	Number of applicants	Number of potential claimants
Beauty Services	B1	1 applicant	1 potential claimant
	B2	2 applicants	2 potential claimants
Education	E1	1 applicant	1 potential claimant
Finance	E1	Commercial Crime Bureau referred the case to Fund	69 potential claimants
Insurance	Ins1	1 applicant	1 potential claimant
Product	Pt1	6 applicants	6 potential claimants
	Pt2	1 applicant: an Incorporated owners of a building	The potential claimant is an incorporated owner of a building, but Fund does not have info about the number of owners of the building
Property	P1	1 applicant	Purchasers of whole development (51 units) were affected because

⁵⁸ Lord Devlin, *The Judge*, 1979, 67 as cited in *Dietrich v R* (1992) 109 ALR 385, 389 Mason C J, McHugh J, as cited by ALRC, cited above.

⁵⁹ Professor R Cranston, cited above, at 151, 157.

⁶⁰ The CLA Fund was set up in 1994 with a Government grant of \$10 million.

⁶¹ The figure of 140 is the minimum number of potential claimants according to the information available. There is difficulty ascertaining the exact number of claimants affected. For example, the P3 group shown in the table involved sales tactics of property, and individual experience might differ.

Type	Case No.	Number of applicants	Number of potential claimants
			the case is about an inoperative communal swimming pool***
	P2	3 applicants	3 potential claimants
	P3	LegCo Councillor indicated that purchasers would like to apply for assistance	Purchasers of whole development (8 blocks) were probably affected but difficult to ascertain number affected as the complaint was against sales tactics. Individual experience might differ***
	P4	1 applicant	1 potential claimant
	P5	1 applicant	1 potential claimant
	P6	2 potential applicants. Mistake in allocation of undivided shares.	Possibly more owners were affected but have no information
	P7	1 applicant	1 potential claimant
	P8	1 applicant	1 potential claimant
	P9	2 applicants	2 potential claimants
	P10	1 applicant	1 applicant (application proceeded with legal action)
Travel	T1	2 applicants	Possibly all tour participants are affected but Fund does not have info about the number***
	T2	3 applicants	Possibly all tour participants are affected but Fund does not have info about the number***
	T3	2 applicants	Possibly all tour participants are affected but Fund does not have info about the number***

*** Note that people who are affected may not necessarily want to be plaintiffs in legal proceedings.

Impact on barristers

6.81 In England, like solicitors, barristers working under conditional fee agreements will be entitled only to an uplift of their profit costs and fees as agreed or allowed on taxation. The uplift will be restricted to a maximum of 100%. Like solicitors, barristers will not be able to claim a percentage of the damages awarded. Solicitors will be expected to fund all necessary

disbursements, which include the payment of counsel's fees unless counsel is also willing to act on a conditional fee basis.

6.82 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. The English Law Society has explained how conditional fee arrangements apply to barristers' fees as follows:

"Payment for advocacy

The cost of advocacy and any other work by us [ie the client's firm of solicitors], or by any solicitor agent on our behalf, forms part of our basic costs.

Barristers who have a conditional fee agreement with us

If you win, their fee is our disbursement which can be recovered from your opponent. You must pay the barrister's uplift fee shown in the separate conditional fee agreement we make with the barrister. We will discuss the barrister's uplift fee with you before we instruct him or her. If you lose, you pay nothing.

Barristers who do not have a conditional fee agreement with us

*If you lose and you have not been paying the barrister's fees on account, we are liable to pay them. Because of this, we add an extra success fee if you win. This extra success fee is not added if you have been paying the barrister's fees on account. If you win, you are liable to pay the barrister's fees."*⁶²

6.83 A practitioner's guide to conditional fees⁶³ highlighted some of the changes to barristers' work brought about by the introduction of conditional fee agreements and the reforms of legal aid in England. The main points are as follows:

- (i) *"There is no doubt that the combined effect of the advent of CFAs, the loss of legal aid funding and the success of the pre-action protocol have placed a considerable cash flow strain on even the most successful chambers. A few years ago, personal injury counsel would have had a constant diet of legal aid advices because of the legal aid certificate requirements in many cases to obtain counsel's advice both on the merits of the case and the level of quantum, and in most cases to obtain further advice on evidence. The entitlement to claim payments on account of those fees provided counsel with a regular income."*⁶⁴

⁶² The Law Society Conditions, Law Society of England and Wales.

⁶³ Mark Harvey, "Guide to Conditional Fee Agreement", Jordans 2002.

⁶⁴ Cited above, at 151.

- (ii) *"The success of the pre-action protocol has seen a considerable reduction in the number of cases going all the way to trial, and thereby requiring counsel's advice, drafting and advocacy. In addition to the loss of payments on account from legal aid, counsel, unlike solicitors, are not receiving the throughput of cases to build up the war chest of fees."*⁶⁵
- (iii) *"Many counsel are becoming involved in cases of the riskier categories, such as work-related upper-limb disorders and stress at work. Understandably, they are reluctant to undertake these on CFA basis. Unfortunately this conflicts with the needs of their instructing solicitors, who require advice and representation in cases of just this type."*⁶⁶
- (iv) *"One of the reasons that solicitors have become increasingly reluctant to instruct counsel is the frequent difficulty of persuading counsel to work on a CFA. They do not wish to instruct them privately because they will have to pay that fee if their client loses. Many of the ATE insurers will not treat counsel as a disbursement. However, this may be the key."*⁶⁷
- (v) *"The judgments in Callery v Gray and Halloran v Delaney have offered no real guidance as to the level of counsel's fees, although the principles of risk which the Court of Appeal enunciated will apply equally to counsel. ... [C]ounsel's experience of risk differs substantially from that of solicitors. To begin with, they are not building up the fees on successful claims in the same way as solicitors and when they are instructed, more often than, not, it is later in the case and with considerably greater risk. ... Indeed, if counsel is being instructed in a case where the pre-action protocol procedure has not produced a settlement, then there is clearly a serious defence. If, as is most common, counsel is not instructed until the drafting of proceedings, or even after exchange of witness evidence, the risk is very considerable. If the matter is going to trial, clearly the defendants believe they can win the claim. This puts the prospects of success at 50/50. There is therefore a substantial ground for setting counsel's success fees at 100%"*⁶⁸
- (vi) *"Counsel should therefore consider setting two success fees ... One at 100% for the matter going to trial and one*

65 As above.
 66 As above, at 152.
 67 As above.
 68 Cited above, at 154.

*lower one to reflect the cost to counsel of losing cases ...”*⁶⁹

6.84 Mark Harvey has also suggested various methods⁷⁰ of financing counsel’s fees:

- (i) *Deferred fees* – This involves counsel’s agreeing to defer his fees until the conclusion of the case. In such a situation, the solicitor bears a greater risk (compared to a case when counsel acts on a conditional fee basis) should the claim turn out to be unsuccessful and, unless the client has agreed to bear counsel’s fees as disbursements, the solicitor should increase the success fee to reflect the higher risk.
- (ii) *Discounted conditional fees* – If the straightforward “no win, no fee” arrangement is not attractive to counsel, the solicitor may try to negotiate a “no win, reduced fee – win, full fee” arrangement.
- (iii) *Varying the terms of the conditional fee agreement* – There is usually a term in the agreement that requires counsel to find an alternative counsel for trial if he himself is not available. This term may be too onerous to counsel if the case is risky. The deletion of the requirement may convince counsel to take on the case.
- (iv) *Counsel’s fees as disbursements* – A small number of ATE insurance providers are able to treat counsel’s fees as disbursements and so counsel will be paid, win or lose.

6.85 These points should be borne in mind in devising any scheme of conditional fees in Hong Kong. It falls to be considered whether barristers should be subject to a higher maximum uplift than solicitors, to mitigate the difficulty of finding a competent barrister to represent clients who have a worthy cause but require conditional fee financing.

Proposals for change

6.86 Having considered the pros and cons of conditional fees, and the related issues of claims intermediaries, litigants in person and the impact on barristers, we have set out our proposals for legislative changes in the next chapter.

⁶⁹ Cited above, at 155.

⁷⁰ Cited above, at 140-141.

Chapter 7

Proposals for reform

The Sub-committee's consultation paper

7.1 In September 2005, the Conditional Fees Sub-committee of the Law Reform Commission of Hong Kong issued a consultation paper which recommended as follows:

- 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.¹
- The proposed structure of the conditional fees regime should differ from that in England in a number of ways: any success fee and ATE insurance premium should not be recoverable from the defendant; a claimant utilising conditional fees should be required by law to notify the defendant of this fact; and the court should have discretionary power to require security for costs in appropriate cases.
- 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.
- Given the success of the Supplementary Legal Aid Scheme ("SLAS") in widening access to justice by using outcome-related 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.
- To cater for the possibility that conditional fees could not be launched (probably due to lack of ATE insurance), and that SLAS could not be expanded, the Sub-committee recommended that consideration should be given to setting up an independent body which the Sub-committee named "the Contingency Legal Aid

¹ Although conditional fees were introduced in England to replace legal aid for various types of cases, the Sub-committee made it clear in the Consultation Paper that the recommendations were intended to operate in parallel with, and to supplement, legal aid, rather than to replace it or justify any reduction in funding.

Fund”.² The functions of this body would be to screen applications for the use of outcome-related 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 who were instructed by the Fund would be paid on a conditional fee basis. Litigants with a good case would therefore have access to the courts without financial exposure.

The consultation exercise

7.2 The consultation exercise was originally scheduled to end on 15 November 2005 but was extended as a result of requests from consultees. Substantial responses were received as late as April 2006, and the last of the written responses was received in October 2006.

7.3 Over 80 individual and organisations took time to provide the Sub-committee with their written responses, and we wish to thank them for their views and comments. A list of those who responded in writing is attached at the end of this Report.

7.4 Members of the Sub-committee attended the Legislative Council’s Administration of Justice and Legal Services Panel meeting on 24 October 2005, as well as a number of discussion forums and media programmes. The views gathered at these occasions were useful in the formulation of the final recommendations.

Should we allow conditional fees?

Views on the proposed conditional fees regime

7.5 We have reviewed the responses to the proposed conditional fees regime and the reasons given. The proposal received the least amount of support from professional bodies, both legal and non-legal. We note also that there was very little support from the insurance sector to this proposal. As for individual legal practitioners (including both barristers and solicitors) and solicitors’ firms, the response was more balanced, although those supporting were out-numbered by those rejecting.

² This body is now more appropriately referred to as “the Conditional Legal Aid Fund” in this report, because of the conditional fee element built into it. Please see the discussion on Recommendation 3 in this chapter.

Arguments advanced by those against the introduction of conditional fees

7.6 Amongst those who were against the introduction of conditional fees, the following arguments were advanced:

- (1) Conditional fees would open the floodgate of frivolous or unmeritorious claims targeting professionals, professional firms or corporations which might be under pressure to settle the case in order to avoid the damage to reputation and the risks of litigation. This would lead to professional indemnity insurance becoming even more expensive (or impossible) to obtain. This would increase operating costs for professionals and businesses and weaken Hong Kong's competitiveness.
- (2) Straightforward claims would be complicated by the involvement of lawyers acting on conditional fees.
- (3) The lawyer's direct interest in the outcome of litigation may adversely affect his ability to act in the best interest of his client and to give objective advice. This might lead to early or heavily discounted settlement, or to more disputes and litigation generally between lawyers and their clients.
- (4) Given the high cost of litigation in Hong Kong, defendants are often inclined to settle low value compensation claims in order to avoid incurring disproportionate legal costs. Conditional fees would reduce the cost liability at stake with a likely consequence of increased lawyer-driven litigation. This would further aggravate the loss of liability insurers in Hong Kong, who have suffered heavy losses on work injury and motor accident claims in recent years. Hence, the local insurance industry does not view the proposed conditional fee regime favourably. Further, it is not envisaged that many insurance companies would be interested in providing ATE insurance; and even if this were available, the premiums would be prohibitively expensive. The ATE insurance market in England had not been shown to be profitable. Given that the market in Hong Kong is much smaller, it is questionable whether it would be viable.

Our observations

7.7 The arguments advanced locally by those against the introduction of conditional fees were similar to grounds raised in other jurisdictions, namely conflict of interest, lawyers' malpractice and the increase of frivolous claims. To these can be added the two major disadvantages of introducing conditional fees experienced in England: first, the generation of satellite litigation; and second, the proliferation of claims intermediaries, which was the market reaction to the change.

7.8 These disadvantages should, however, be balanced against the improvement in terms of access to justice, especially for the middle income group. We believe that conditional fees would improve access to justice and this view coincides with the oral evidence given by England's Law Society to the House of Commons Select Committee on Constitutional Affairs, which will be discussed later in this chapter.

Access to justice

7.9 Access to justice is one of the fundamental rights constitutionally protected by the Basic Law.³ If some segments of society cannot afford to pay legal costs, they are to some extent deprived of the right of access to justice. The inherent characteristic of conditional fees of facilitating access to justice is probably the most valid argument in favour of the introduction of conditional fees. They enable litigants to retain a lawyer in circumstances which would otherwise, because of the cost deterrent factor, not be possible.

7.10 If conditional fees are introduced, access to justice and the means to seek a legal remedy would be provided to a significant proportion of the community who are currently neither eligible for legal aid nor able to fund litigation themselves.

Access to justice for the middle-income group

7.11 The central premise of the proposal to allow a restricted use of conditional fees is that conditional fees could enhance access to justice in Hong Kong, especially for the middle-income group. Consultees who supported the recommendation agreed that there is a significant portion of the community who are not eligible for legal aid but cannot afford the high costs of litigation. This group of persons can benefit from the introduction of conditional fees.

7.12 To the middle-income group which is neither eligible for the Ordinary Legal Aid Scheme ("OLAS") nor SLAS, a properly structured conditional fees regime can be a powerful tool for securing proper legal representation to help right wrongs and to obtain appropriate redress. It is important to ensure that proper legal representation in a civil claim is not 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.

³ Article 35: "*Hong Kong residents shall have the right to confidential legal advice, access to the courts, choice of lawyers for timely protection of their lawful rights and interests or for representation in the courts, and to judicial remedies. Hong Kong residents shall have the right to institute legal proceedings in the courts against the acts of the executive authorities and their personnel.*"

Enhanced access to justice

7.13 Introduction of conditional fees could also enhance access to justice by reducing the number of unmeritorious cases conducted by litigants in person. This is because persons who are not eligible for OLAS (by reason of means) or SLAS (by reason of type of case) and who do not wish to pay for lawyers themselves may realise – when their case has been declined by lawyers (whether acting on a conditional fees basis or acting for the fund referred to later in this chapter) – that their case has been objectively examined by lawyers and considered to lack sufficient merits. Of course a rejection by lawyers will not deter those litigants in person who are blinded by subjective or imbalanced perceptions of the merits of their case, but it may cause others to seriously reconsider before proceeding with litigation. That would be beneficial to those litigants who may thus be deterred from launching mis-conceived litigation which might be potentially ruinous not only for themselves but also for the defendants who were unnecessarily dragged into such litigation (there have been instances of owners of small flats suing other owners of the building in misconceived litigation and incurring so much costs that they end up losing the flats and other assets). A reduction in these cases would be to the benefit of the courts and the general public as a whole, as judicial resources could then be redirected towards resolving more worthwhile disputes and the waiting time for hearings could also be reduced.

Counter-arguments

7.14 Some have argued that any enhancement of access to justice brought about by outcome-related fees would benefit only a limited class of potential users of the legal system – namely, potential claimants in civil cases with reasonable prospects of recovery. These critics argue that outcome-related fees would disadvantage the lawyers' other normal fee clients as they would be subsidising the lawyers' losses through the payment of higher fees.⁴

7.15 We consider that this argument is flawed for several reasons. First, it assumes that lawyers would suffer financial losses from outcome-related fees. For the lawyer who is generally accurate in assessing the merits of the case, it cannot be safely assumed that he will suffer losses. Second, even if the lawyer suffers financial losses, whether or not he can pass on the losses to other clients by increased fees is open to question, and would depend on numerous factors, such as the fees charged by his competitors and whether his clients are price-sensitive. Third, even assuming that there would be problems associated with widening access to justice by means of outcome-related fees, the problems do not justify denying access to justice and proper legal representation to claimants with worthwhile cases.

7.16 Hence, even though there may be problems associated with conditional fees, their usefulness in widening access to justice and providing

⁴ South African Law Commission, *Report on Speculative and Contingency Fees* (1996), at 3.3.

proper legal representation in our view justify their further consideration.

The United Kingdom's House of Commons Select Committee on Constitutional Affairs

7.17 In this connection, we observe that recent findings in England support the view that conditional fees can indeed enhance access to justice. As discussed in Chapter 3 above, the United Kingdom's House of Commons Select Committee on Constitutional Affairs issued a report⁵ examining the compensation system in England and Wales, including the effect of the move to "no win, no fee" conditional fee agreements.⁶ The Select Committee referred to a report produced by the Civil Justice Council⁷ which discussed the middle-income group caught in the access to justice gap. They coined the term "Middle Income Not Eligible for Legal Aid Services" (MINELAS). It was thought that conditional fees would allow this group to obtain access to justice.

7.18 In oral evidence to the Select Committee, Anna Rowland of the Law Society confirmed that this had proved to be one of the advantages of conditional fee agreements. She said:

*"[T]he eligibility rates for the legal aid are now very low, whereas [conditional fee agreements] have opened up the possibility of getting redress for middle-income people who would have had no hopes of getting legal aid and they would not have had enough money to fund the case themselves, so there is a whole tranche of people who had no access there who will now be getting access."*⁸

7.19 The Select Committee Report, however, also referred to another report issued by Citizens Advice⁹ which set out a number of concerns about the conditional fees system:

⁵ Third Report, February 2006.

⁶ The inquiry's terms of reference were to answer the following questions:

- Does the "compensation culture" exist?
- What has been the effect of the move to "no win, no fee" conditional fee agreements?
- Is the notion of a "compensation culture" leading to unnecessary risk aversion in public bodies?
- Should firms which refer people, manage or advertise conditional fee agreements be subject to regulations?
- Should any changes be made to the current laws relating to negligence?

⁷ Improved Access to Justice – Funding Options and Proportionate Costs, August 2005.

⁸ At para 7.

⁹ "No win, No fee, No chance" (December 2004). Citizens Advice is the operating name of the National Association of Citizens Advice Bureaux, London. Citizens Advice and each Citizens Advice Bureau are registered charities. They provide free information and advice on matters including debt, benefits, housing, legal, discrimination, employment, immigration, consumer and other problems. Service is rendered through over 21,000 trained volunteers in nearly 3,400 locations, including in bureaux, hospitals, colleges, prisons and courts. Citizens Advice also co-ordinates social policy, media, publicity and parliamentary work.

- There was widespread mis-selling of legal and insurance products, and consumers were often induced into signing conditional fee agreements inappropriately.
- Consumers were subjected to high-pressure sales tactics by unqualified intermediaries introducing them to a legal process. Inappropriate marketing and sales practices were used – for example, salesmen approaching accident victims in hospital.
- Insurance premiums were financed by loans. The interest, together with the legal costs, eroded the value of claimants' compensation. In some cases consumers even owed money at the end of the process. This turned the whole claims process into a zero-sum game for consumers and denied effective access to compensation.
- Conditional fee agreements created perverse incentives for the legal profession and provided the conditions for cherry-picking of high value cases with high chances of success.
- The activities of claims management companies seemed to fall largely outside the system of regulation.

7.20 In another article¹⁰ it was reported that Citizens Advice had handled 130,000 problems relating to conditional fee arguments since 2000. While the statistics provided by the Department for Constitutional Affairs demonstrated that the introduction of CFAs had not precipitated a huge rise in recorded claims (the figures show a drop of 5% between 2000 and 2005), the poor reputation of claims management companies and the proliferation of misleading advertisements might have helped add to the perception of a “compensation culture” where people believe they can seek compensation for any misfortune that befalls them, even if no-one else is to blame.¹¹

7.21 In its oral evidence to the Select Committee, Citizens Advice said that:

“You have opened up access to justice through a market solution, but you have not introduced the protections that might be needed to make sure that the market worked effectively for consumers, and the legal services market for that matter as well. That has led to a reputational effect for the whole legal services market which we are now trying to fix up by introducing some regulation of claims handlers. It is a pity we are having to do that after the event with the introduction of regulation. The whole package of introducing [conditional fee agreements] was not accompanied

¹⁰ “Removing the high stakes of „no win – no fee””, Jon Robins, The Times, 10 January 2006.

¹¹ Definition of “compensation culture” taken from the UK paper on “Tackling the „Compensation Culture” – Government Response to the Better Regulation Task Force Report: Better Routes to Redress” (10 Nov 2004).

by proper consumer protection measures in anticipation of some of the problems that we have seen.”¹²

ATE insurance

Problems with ATE insurance in England

7.22 Conditional fees have been in operation in England since 1995, but the ATE insurance market has not been particularly stable. The Civil Justice Council in its Report on “Improved Access to Justice – Funding Options & Proportionate Costs”¹³ wrote that:

“It was thought that conditional fees would enable [the Middle Income Not Eligible for Legal Aid Services] group to obtain access to justice. However, the essential ingredient of an ATE policy to support [conditional fee agreements] at an affordable premium is a limitation on putting an affordable funding package in place”¹⁴

7.23 The Civil Justice Council stated further that:

“Although we believe a Contingency Legal Aid Fund may ultimately take over from Conditional Fees, and possibly even the remaining civil legal aid – should the After the Event insurance market collapse – we are only able to test it where it is not in competition with conditional fees.”

7.24 We note also that, according to Senior Costs Judge Peter Hurst:

“The level of conflict over CFAs (conditional fee agreements), and particularly after-the-event (ATE) insurance, is as high as ever, ... The difficulties with ATE are enormous. It’s a very young market, and some of the year’s early entrants lost a great deal of money. ... If the ATE market collapses, the CFA regime will also collapse, and then we would have no access to justice. ...”¹⁵

Prospects of ATE insurance in Hong Kong

7.25 Given the experience of ATE insurance in England, which is a much more substantial market with better ability to spread risks, and given also the responses received from the Hong Kong insurance sector, we believe it is unlikely that there would be a consistent number of professional players offering ATE insurance in Hong Kong on a long term basis. It is significant

¹² Question 238.

¹³ August 2005.

¹⁴ At p 31.

¹⁵ Litigation Funding, Issue 44 of August 2006, at pages 4-5.

that in England the premium for ATE insurance for simple road traffic accident cases is not significantly lower than the legal costs of an undefended action.

7.26 Given that there are over 180¹⁶ insurance companies in Hong Kong, it is possible that some insurance companies would be willing to enter the ATE insurance market, at least initially. However, those from the insurance industry who responded to our proposals were sceptical as to the likelihood that ATE insurance could be offered in Hong Kong on a long term basis at rates which were commercially viable, without being prohibitively expensive for the consumer. Without ATE insurance a conditional fee regime would be difficult to sustain.

Conditional fees without ATE insurance

7.27 In the light of the uncertainty surrounding the availability of ATE insurance in Hong Kong, we have considered whether it is advisable to recommend conditional fees in the absence of ATE insurance. As explained in greater detail in Chapter 1 above, the costs indemnity rule operates in Hong Kong. This means that the unsuccessful litigant will usually be ordered to pay the legal costs of the successful party, in addition to his own. Hence, an unsuccessful claimant who has a conditional fee arrangement will be relieved from paying his own lawyers, but will still be liable to pay the defendant's legal fees unless he has obtained ATE insurance cover for his liability under the costs indemnity rule.

7.28 We are aware that in England claimants are not obliged by law to obtain ATE insurance, and some claimants may choose not to do so for a variety of reasons. At one extreme, in circumstances such as those in *King v Telegraph Group Ltd*,¹⁷ for instance, an impecunious claimant might not take out ATE insurance either because he could not afford to pay the premium or because he did not see the need to obtain ATE insurance (perhaps because he is prepared to take the risk of financial ruin as a result of his inability to pay the other side's costs). The defendant in such circumstances faces a "lose/lose" situation because if he loses, he would have to pay damages and costs to the claimant; whereas even if he wins, he would not be able to obtain costs from an uninsured impecunious claimant. We are not in any way encouraging this type of claim, but the objective fact is that claims by impecunious claimants suing on a conditional fee basis without ATE insurance have been raised.

7.29 At the other extreme, a wealthy corporate client might choose to use conditional fees without obtaining ATE insurance after balancing the amount of the premium, the likelihood of losing the case and their financial ability to pay for the other side's costs should the need arise. Hence, conditional fees without ATE insurance might offer an additional choice of litigation funding in the above two contrasting situations.

¹⁶ As at 30 September 2006.

¹⁷ [2004] EWCA Cir 613. See discussion Chapter 4 above.

7.30 However, for the average citizen who has limited assets (or in the words of the England's Civil Justice Council, the "Middle Income Not Eligible for Legal Aid Services" group), the risk of having to pay the other side's legal costs in the event of losing would probably render a conditional fee arrangement without ATE insurance unattractive. They are not rich enough to be able to absorb the other side's costs, and would face financial ruin if required to pay the other side's costs. It is, however, precisely this group of potential claimants that a conditional fee arrangement is supposed to assist. This fact, together with the problems associated with a conditional fee regime, has led us to revise our tentative recommendation on conditional fees.

Recommendation 1

Having regard to the likelihood that insurance to cover the opponent's legal costs should the legal action fail would not be available at an affordable premium and on a long-term basis in Hong Kong, we believe that conditions at this time are not appropriate for the introduction of conditional fees, save in the circumstances set out in Recommendations 3 and 4 below.

Expansion of the Supplementary Legal Aid Scheme

7.31 The Conditional Fees Sub-committee recommended in its consultation paper that the self-financing SLAS operated by the Legal Aid Department should be expanded on a gradual incremental basis by raising the financial eligibility limits and by increasing the types of cases covered. This way, access to justice can be widened without incurring additional public funds.

Consultees' responses

7.32 With the exception of governmental departments, almost all consultees were supportive of this recommendation. The general view was that the financial eligibility limits were too low.

7.33 The expansion of SLAS was the only option supported by the Hong Kong Bar Association (HKBA). They believe in principle there should not be any difficulty in expanding the scope of SLAS to cover the types of cases identified in the consultation paper as appropriate for conditional fees. As for the eligibility test, they believe the current limit of HK\$439,800 should be revised to, say, HK\$2 million. The HKBA said this limit was provisional and was intended as a basis for discussion. The underlying principle was that it was not against the public interest to oblige an individual to fund his own litigation where he had financial resources above a certain level.

7.34 The Law Society's response supported the recommendation to expand SLAS. The Law Society went on to suggest that SLAS should be expanded to cover all categories of claims, irrespective of the means of the applicant, although those who were not financially eligible under the current limits might be called upon to pay a higher contribution and be subject to a larger amount of first charge on the damages recovered.

7.35 The Government's stance in rejecting the expansion of SLAS was based on the following points:

- (1) It estimated that about 55% of households in Hong Kong were financially eligible for OLAS, and about 15% of households in Hong Kong were financially eligible for SLAS. Hence, the percentage of households covered by OLAS and SLAS together was about 70%.
- (2) For SLAS to remain self-financing, SLAS had to concentrate on cases with a high success rate and a high damages to costs ratio. There was therefore little scope for expansion.
- (3) The contribution rate for SLAS had been reduced from 12% to 10% of the damages awarded. The SLAS Fund of \$93 million as at 30 September 2005 was the total accumulation since 1984 and included a \$27 million Government injection in 1995. The rates of contribution had been reduced in 2000 and had led to a steady reduction in the annual surplus in recent years. There was little scope for SLAS to absorb more types of civil cases.
- (4) Although SLAS had a higher financial eligibility limit, the target group continued to be persons with limited means. If that ceased to be the case, there would be little policy or operational basis for SLAS to be operated by the Legal Aid Department.

7.36 The Legal Aid Services Council (LASC), however, supports expansion of SLAS. LASC is a statutory body set up in 1996 to advise the Chief Executive on legal aid policy, to oversee legal aid services, and to advise on the feasibility and desirability of establishing an independent legal aid authority. LASC made the following points:

- (1) The contribution to the SLAS fund from successful claims for substantial damages can be used to support other deserving cases which have public interest elements.
- (2) SLAS is efficient, cost-effective and fully-tested. It safeguards professional ethics and avoids conflict of interest problems. It is simple, safe and affordable for both society and the individual.
- (3) SLAS should be widened to cover more types of civil cases.

- (4) Given the increase in activities and caseload to be expected of the expanded SLAS, the public is concerned that legal aid should be independent of the government and devoid of any bureaucratic connotation. A statutory body with responsibility for the full operation of the new scheme (preferably with the Legal Aid Department as the executive arm and administrative costs kept low) is an alternative to the conditional fee arrangements proposed.

Our views

7.37 Given the widespread support for the expansion of SLAS, we would recommend the expansion of SLAS on a gradual and incremental basis in two ways. The first is to raise the financial eligibility limits to bring a higher proportion of households within the Scheme's ambit. We do not think that raising the financial eligibility limit would adversely affect the financial viability of the SLAS Fund. To enhance the financial position of the SLAS fund, and as suggested by the Law Society, applicants who are above the existing financial eligibility of HK\$439,800 could be asked to pay a higher contribution rate than the existing 10%. Even (say) a 15% contribution rate would be substantially lower than the rate of about 25%-30% commonly charged by un-regulated claims intermediaries.

7.38 As to the point in paragraph 7.35(4) above, the increase in the financial eligibility limit is not supposed to be extravagant. The Scheme, even after this increase, would continue to be a scheme which serves the needy, not the rich.

7.39 The second way in which SLAS should be expanded is by increasing the types of cases covered. At present, SLAS covers personal injury, death, medical, dental and legal professional negligence cases (where the amount at stake is more than HK\$60,000), and employees' compensation claims. Between 2001 and 2006, SLAS took up about 100 to 200 cases a year,¹⁸ We believe SLAS is a successful funding option which can widen access to justice and should be expanded.

Recommendation 2

Given the success of the Supplementary Legal Aid Scheme in widening access to justice through the payment of a portion of the damages recovered by the successful applicants, and also given the widespread support for its expansion, we recommend that SLAS should be expanded

¹⁸

In 2001, SLAS took up 220 cases; in 2002, 162 cases; in 2003, 106 cases; in 2004, 120 cases; in 2005, 158 cases and in 2006, 137 cases. Possible causes for the declining number are: competition from claims intermediaries, increased eligibility for OLAS given the increase in statutory allowances, and fluctuations in the wages level.

on a gradual and incremental basis by, firstly, raising the financial eligibility limits and, secondly, increasing the types of cases covered by SLAS, having regard to maintaining the financial viability of SLAS.

Setting up of a privately-run conditional legal aid fund

7.40 The consultation paper examined the idea of setting up an independent body which would screen applications to use outcome-related fees, finance the litigation, take a share of the compensation in successful cases, and also pay the defendants' legal costs in unsuccessful cases. This body 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. We believe that this independent body or central fund would be a sustainable and efficient structure for widening access to justice; and provided that it is properly structured, it has the potential to surpass SLAS. We are aware that if the scope of SLAS can be significantly expanded by raising the financial eligibility limits substantially, and by increasing the types of cases covered, better access to justice can be achieved at relatively little cost. Leaving aside the issue of cost, however, an independent conditional legal aid fund would be able to support more desirable features than an expanded SLAS, including the ability to cope with market demands and to offer an additional choice to litigants who might have otherwise patronised claims intermediaries,¹⁹ some of whose activities may be of doubtful legality. Therefore, whether or not the expansion of SLAS can be implemented, the feasibility of setting up this independent body or central fund should be seriously considered.

7.41 This new body would be similar to, but not the same as, the "Contingency Legal Aid Fund" proposed by the English Bar. Under the English Bar's proposal there would be no financial eligibility test, hence providing access to justice to those ineligible for legal aid. Successful plaintiffs would pay an agreed proportion of their winnings into the proposed fund which would be used to meet the costs of unsuccessful cases. The English Bar conducted a preliminary feasibility study which found that the proposed fund could be self-financing but might need a start-up loan from the Government. The English Bar had hoped that the proposed fund would cover a wide range of cases, but the feasibility study suggested that, for the proposed fund to be financially viable, it would have to concentrate on those categories of litigation with high success rates and with a good damages-to-costs ratio. Essentially, this would cover mostly actions for personal injury. The feasibility study did not include in its analysis other damages and contract cases.

7.42 In fact, a contingency legal aid fund (without the conditional fee element) 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

¹⁹ See paras 6.30-6.54 above.

Jurists).²⁰ The idea was raised again in 1978 and 1992, when Justice proposed running a pilot scheme with a small amount of initial funding from the Treasury.²¹ The UK Government rejected this proposal on several occasions²² 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.²³ Further reasons advanced for not taking on the English Bar's proposal for a contingency legal aid fund were:

- It 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.

7.43 Despite the reluctance of the UK Government to set up a contingency legal aid fund, 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 private contingency legal aid fund.²⁴ 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 contingency legal aid fund. 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.

Views on a conditional legal aid fund

7.44 The responses received on the setting up of a conditional legal aid fund were balanced: half of the responses supported the idea while the other half did not.

²⁰ UK Department for Constitutional Affairs, "Making simple CFAs a reality", 29 June 2004 at para 58.

²¹ Litigation Funding, February 2006, at page 1.

²² CLAF was rejected by the Legal Advisory Committee on Legal Services in its 28th report, and the Benson Report in 1978. Proposals for a CLAF were again submitted for the Legal Aid Bill 1988 and the Courts and Legal Services Bill 1990.

²³ UK Department for Constitutional Affairs, cited above, at para 58.

²⁴ As above, at para 60.

7.45 The response from the Government's Director of Administration stated that a non means-tested scheme, whether or not coupled with a merits test, fell outside the purview of their legal aid policy. Nevertheless, they observed that, should such a scheme be set up, it would seem appropriate to consider whether the legal professional bodies should take on responsibility for the conditional legal aid fund, given their familiarity with the operation of SLAS. In this regard, it is noted that at present, the Duty Lawyer Service is administered jointly by the two legal professional bodies through the council of the Duty Lawyer Service.

7.46 The Bar Association did not support the proposal while the Working Party of the Law Society considered that the establishment of a conditional legal aid fund deserved further consideration. The Working Party raised concerns as to the source of the seed money to establish the fund, and whether such a fund would generate enough income to be self-financing.

7.47 The Legal Aid Services Council was also against the proposal. It believed that a separate conditional legal aid fund would lead to the failure of SLAS and would adversely affect OLAS, thereby placing a greater fiscal burden on the public purse.

England's Civil Justice Council's Report on "Improved Access to Justice – Funding Options & Proportionate Costs"²⁵

7.48 As one of the means to improve access to justice, England's Civil Justice Council ("CJC") recommended that:

*"With a view to increasing access to justice and providing funding options in cases where ATE insurance is unavailable, the Legal Services Commission should give further consideration to the Conditional Legal Aid Scheme (CLAS) previously proposed by the Law Society, the Contingency Legal Aid Fund (CLAF) previously proposed by the Bar Council and JUSTICE, and the Supplementary Legal Aid System (SLAS) operating in Hong Kong."*²⁶

7.49 The CJC stated that for many years thought had been given to the idea that the gap between lack of funding for those who were not eligible for legal aid and access to private funding for those who could afford to pay, might be bridged by some form of central fund that could give financial support to litigants in return for a share of any winnings recovered.

Other bodies in England

7.50 Citizens Advice stated in its report in late 2004 that although it saw some problems with a contingency legal aid fund, the greater problems

²⁵

August 2005.

²⁶

Recommendation 10 at p.12.

with conditional fee agreements, and the appeal of a sustainable, predictable and efficient structure meant that the government should carry out a feasibility study into establishing a contingency legal aid fund.²⁷

7.51 Both Lord Woolf in his 1996 Access to Justice report, and Sir Peter Middleton, who conducted a review of civil justice and legal aid in 1997, considered a contingency legal aid fund to be a concept worth exploring further especially in relation to more expensive cases where the risk under a conditional fee agreement might be too much for the solicitors to take.²⁸

Our observations

7.52 In our view, a conditional legal aid fund has advantages over ordinary conditional fee agreements. The fund would undertake work on a much larger scale than an individual law firm. It would be able to fund disbursements without borrowing and could self-insure against costs. This would enable the conditional legal aid fund to bear the risk of some cases that could not be run under ordinary conditional fee agreements. Hence, a conditional legal aid fund should be able to take on some worthwhile but higher-risk cases once it has built up adequate reserves.

7.53 Also, given the features of the proposed conditional legal aid fund which will be set out in this chapter, we believe it would be different from both OLAS and from SLAS and would not lead to adverse competition. We do not think that a conditional legal aid fund would adversely affect OLAS or place a greater burden on the public purse. First, OLAS is not self-financing but is funded directly from public funds. If more cases originally under OLAS can be taken up by a conditional legal aid fund, then public expenditure would be reduced. Second, although some might argue that the “good” cases would go to the conditional legal aid fund, we believe that the OLAS merits test should be able to weed out unmeritorious cases. Thus, OLAS will not end up with “bad” cases.

7.54 Further, allowing only a conditional legal aid fund to employ conditional and contingency fees²⁹ would have the added advantage that the common law offences of maintenance and champerty could be retained, thereby avoiding the problems which might be caused by a proliferation of claims intermediaries.

Fee arrangements for the proposed fund: conditional fees or normal fees?

7.55 We are aware that if the proposed fund uses contingency and normal fees in the same way as SLAS, then the scheme would be simple, easy to understand, and would be more readily acceptable to lawyers and clients

²⁷ Litigation Funding, February 2006, at page 2.

²⁸ As above.

²⁹ As to which, see para 7.57 below.

alike. However, there are advantages if SLAS and the proposed fund could maintain some product differentiation. If a conditional fee element (as between the proposed fund and the lawyer) is introduced, the scheme would be more complicated. Success will have to be defined and the problem of appeal, both after trial and from interlocutory orders, would need to be addressed. However, these are issues which have to be addressed in any system incorporating outcome-related fees. The conditional fee element would enable the proposed fund to achieve savings both as to legal costs and as to supervision costs, as lawyers acting on a conditional fee basis are unlikely to prolong cases unnecessarily.

7.56 If we maintain product differentiation between SLAS and the proposed fund, then if the latter is properly structured, it might in future support features which SLAS cannot afford. For instance, access to justice should not be confined to claimants. Ideally, we do not want to exclude defendants from using the proposed fund. The existing SLAS, however, caters only for claimants. The problem with taking on defendants as clients is that there would not be any compensation from which to take a cut. However, if the conditional fee element were adopted it is possible for the proposed fund to offer a “product” by way of acting for respondents/defendants, whereby if a case is lost (and what amounts to “lost” would require definition) then the proposed fund would pay the other side's costs, but would not have to pay its own lawyer's costs. This possibility of acting for defendants is something which the proposed fund can consider after its operation has reached a stage of maturity.

7.57 We are inclined to think that the proposed fund should differ from SLAS, in that, as between the proposed fund and the client, contingency fees will be charged; while as between the proposed fund and the lawyer, conditional fees will be utilised. It is true that under such arrangements lawyers run the risk of not getting paid if the case is lost, but that would be balanced by the opportunity to receive a success fee in addition to normal fees where the case is won. Younger members of the profession might see this as an opportunity to take on cases to gain experience, and lawyers generally would have the choice to take on any combination of normal fee or conditional fee cases to suit their own circumstances. Given this conditional fee element in the proposed fund, we believe it should appropriately be called the “Conditional Legal Aid Fund” (CLAF).

Recommendation 3

We recommend that a new fund, the Conditional Legal Aid Fund (“CLAF”), should be set up together with a new body to administer the fund and to screen applications for the use of conditional fees, brief out cases to private lawyers, finance the litigation, and pay the opponent's legal costs should the litigation prove unsuccessful. We recommend that CLAF should be permitted to engage the private

lawyers it instructs on a conditional fee basis, while CLAF (in the same way as SLAS) should be permitted to charge the client on a contingency fee basis. We recommend that CLAF should initially accept applications from claimants only, but the long-term goal is for CLAF to also cater for defendants after CLAF has built up adequate reserves.

Should CLAF be run by the Legal Aid Department or should it be run independently?

7.58 There are pros and cons to both options. If CLAF were to be run independently, then a new body would have to be set up and this might entail extra resources. On the other hand, if CLAF were to be run by an existing organisation, there might be resistance from the existing organisation which would take time to resolve and address.

7.59 There are numerous advantages in having CLAF administered by the Legal Aid Department, which is already running OLAS and SLAS. First, this “one-stop shop” would be attractive and convenient to applicants who presumably would have to file only one application which would be directed to the most appropriate scheme according to eligibility. Second, this structure should achieve savings in administrative costs as it could avoid duplication. Third, if CLAF were run by the Legal Aid Department rather than a private organisation, it would offer better safeguards against malpractice and conflicts of interest between clients and the legal profession.

7.60 However, there are obvious advantages in having CLAF run by a new body under the governance of an independent board. First, in order for CLAF to successfully attract litigants, CLAF would have to develop and adjust its own services and strategies from time to time. The Legal Aid Department’s structure and personnel are not designed or trained to cope with these tasks. To provide the optimum environment for CLAF to perform its tasks, the management structure and personnel should be tailor-made for CLAF. Second, if CLAF were to be governed by an independent board instead of a governmental department, it would be much better placed to carry out its mission and objectives independently and could be seen by the public to be doing so. Third, if CLAF could thrive while financially and administratively independent from the Government, it is hoped that in the long run some users of OLAS could be attracted to use CLAF. We do not intend that CLAF should or could replace the existing legal aid schemes, but a mature CLAF would offer an additional choice of funding litigation to the public.

If insurers find conditional fees unpalatable, would CLAF (which utilises both conditional and contingency fees) be successful?

7.61 Whilst insurers have to compete with each other for profits, CLAF’s profits would not be taken out of the Fund, but would be ploughed back

to finance other cases. CLAF would have a monopoly of the combined use of conditional and contingency fees. Although CLAF will have to compete with claims intermediaries,³⁰ some of whose activities may be of doubtful legality, CLAF will enjoy a definite edge over claims intermediaries in terms of goodwill and management. The viability and success of CLAF would depend very much on successful promotion of the scheme and correct application of the merits test. The experience of SLAS gives confidence that CLAF, if ably and cautiously run, should be financially viable.

7.62 Having considered these arguments, we believe CLAF could be more successfully run by a new independent body rather than the Legal Aid Department.

Recommendation 4

We recommend that the Government should carry out a feasibility study into establishing CLAF as a statutory body under the governance of an independent board empowered by legislation to fulfil the functions set out in Recommendation 3.

Eligibility for CLAF

7.63 In one of its tentative recommendations, the Sub-committee recommended that applicants for CLAF should not be means-tested. Having considered the matter afresh, we believe that some financial eligibility limit should be set, although the limit should be high given the generally high costs of litigation in Hong Kong. We suggest that CLAF should have an upper financial eligibility limit, but should not have a lower limit. Hence, persons eligible for OLAS and SLAS would also qualify to apply for CLAF.

Competition between the schemes

7.64 It has been suggested that OLAS, SLAS and CLAF would be competing for low risk cases, and the schemes should avoid direct competition in order to minimise cost. We believe, however, that CLAF would not be competing directly with OLAS and SLAS. The three schemes have their own distinct features and would appeal to different litigants in different cases. First, the costs liability would be different. From the prospective litigants' point of view, OLAS has the most advantageous treatment in terms of costs liability and contribution regime out of money recovered from successful litigation. OLAS would probably be the first port of call for all those who are financially eligible for OLAS. For those prospective litigants who do not qualify for OLAS on means, it is their financial position that will chiefly determine if they go for

³⁰ See paras 6.38-6.53 above.

SLAS or CLAF in those cases where coverage is common to both schemes. The fact that CLAF charges a success fee and a higher percentage contribution than SLAS would be likely to persuade many who are eligible for SLAS and CLAF to choose the former. Although SLAS is a successful self-financing scheme, it is relatively small-scale. In 2001, SLAS took up 220 cases; in 2002, 162 cases; in 2003, 106 cases; in 2004, 120 cases; in 2005, 158 cases and in 2006, 137 cases. OLAS and SLAS together cater for claimants with financial resources up to \$439,800. If the upper financial eligibility limit of CLAF is set at, say, \$2 million, coupled with a wider coverage in terms of types of cases, it is possible that CLAF would take up more cases than SLAS. The feasibility study on CLAF should endeavour to find out more on this aspect.

7.65 Although many litigants would be influenced by the costs liability factor discussed above, to cater for litigants who would choose CLAF because they prefer the enhanced service or because their cases are not covered by the other two schemes, CLAF should not have a minimum financial eligibility limit; that is, persons eligible for OLAS and SLAS should also qualify to apply for CLAF. CLAF should enjoy this slight advantage because CLAF is self-financing while OLAS is financed by public funds.

7.66 We believe OLAS, SLAS and CLAF each have their own distinctive features. First, the schemes have different financial eligibility limits and would be of assistance to litigants with different financial resources. Second, CLAF aims to provide better service given that litigants would have to pay higher fees (in the form of success fees and contribution). Third, the types of cases covered by the schemes are not the same. Hence, we believe the creation of CLAF can help to fill gaps in the services provided by OLAS and SLAS.

Competition with the private sector

7.67 Some might be worried that CLAF would compete with the private sector for clients. We believe, however, that CLAF would compete directly with claims intermediaries (because they both charge contingency fees) and then re-direct the cases to the private sector practitioners instructed by CLAF. In any event, CLAF's target is those who have inadequate means to privately finance litigation, and the financial eligibility limits of CLAF could ensure that CLAF would not be competing with the private sector. Even if it is to be assumed that there may be some overlap between CLAF and the private sector, it is envisaged that healthy competition is likely to enhance the efficiency and quality of legal services.

Small and medium-sized enterprises and limited companies

7.68 Apart from individuals who can satisfy the means test, we believe that CLAF should also cover sole proprietors and partnerships that come under the definition of "small and medium-sized enterprises" ("SMEs").

According to the Trade and Industry Department, “*manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees*” are considered to be SMEs. Although the Trade and Industry Department's definition of SMEs might not be 100% satisfactory, it is a widely accepted yardstick³¹ and should be adopted by CLAF as the general definition of SMEs. To cater for some exceptional cases, CLAF should be empowered to consider other financial resources, such as net assets and turnover.

7.69 We have deliberately excluded limited companies from our definition of SMEs. While there are many genuine small businesses which choose to operate as limited companies, the concept of a “small” limited company could be elusive, since a two-dollar company might be owned by a tycoon or a big corporation. We have also taken into consideration the fact that the fund would have a limited endowment and the main thrust, especially at the initial stage, should be to lend assistance to individuals, sole proprietors and partnerships.

7.70 We believe limited companies should not be eligible for CLAF, at least initially, but the issue should be reviewed when CLAF is in a position to consider expansion. As for charities, welfare organisations and non-governmental organisations, although many of these organisations warrant assistance, we consider that it would be better for CLAF to start on a limited basis and to expand gradually as circumstances allow.

Recommendation 5

We recommend that applicants for CLAF should be subject to a means test which should have a generously set upper limit, but should not have a minimum financial eligibility limit. We recommend that the feasibility study into establishing CLAF should be carried out irrespective of whether the Supplementary Legal Aid Scheme is expanded. Individuals, sole proprietors and partnerships falling within the definition of “small and medium-sized enterprises” should be eligible to apply. “Small and medium-sized enterprises” refer generally but not exclusively to manufacturing enterprises with fewer than 100 employees, and non-manufacturing enterprises with fewer than 50 employees. Applications would be considered on a case by case basis taking into consideration other factors such as financial resources. We recommend a review in due course to consider expansion to include limited companies which satisfy the “small and medium-sized enterprises” criteria.

³¹

It is more satisfactory than, say, net profits which could drastically vary from year to year, and could be more easily manipulated than the number of employees.

The merits test

7.71 We are satisfied with the way in which the merits test is operating in respect of cases under OLAS and SLAS, and intend that the same merits test should be adopted for CLAF. The existing test is that the approving body must be satisfied that there are reasonable grounds for taking, defending or being a party to the proceedings. In other words, the test is whether the applicant has reasonable prospects of success. Both facts and law will be considered, and the approving body will take into account the availability and strength of evidence to support the facts alleged. Basically, if a claim has a better than 50 per cent prospect of success, the legal merits test will for practical purposes be treated as satisfied, though approval may still be withheld on other grounds.

7.72 The applicant must also satisfy the “reasonableness test”. This means that an application for a case which otherwise possesses sufficient merits to pass the merits test will still be refused if, in the particular circumstances of the case, it appears unreasonable that the applicant should be granted legal aid. This is a wide and general test under which the approving body can take into account all the factors which would influence a private client considering taking proceedings (the so-called “private client test”). An application will only be approved in circumstances where a client of moderate means paying privately would be advised to litigate:

“The notional private client being advised must be taken to be a person with adequate means to meet the probable costs of the proceedings, but not with over-abundant means, so that paying the costs would be possible, although something of a sacrifice.”³²

7.73 Factors that will be considered include: whether the benefits to be obtained in the proceedings justify the likely costs of the proceedings, whether it is likely that any judgment obtained could be enforced on the defendant, and the importance of the case to client, which is assessed as objectively as possible.

7.74 Since it is fundamental that CLAF be self-financing and maintain its financial viability, CLAF should have an overriding discretion to turn down an application even where the merits test is satisfied.

Appeal panel

7.75 To provide an appeal mechanism for applicants not satisfied with CLAF’s decision to refuse funding, we suggest that an appeal panel should be set up, so that the decisions of CLAF’s management staff would be subject to

³² The Legal Aid Board, *Legal Aid Handbook* (Sweet & Maxwell, 1998), at 7-01.5.

review. This appeal mechanism should not be confused with an appeal to the Courts.

Recommendation 6

We recommend that to be eligible for CLAF, an applicant must satisfy a merits test; that is, the applicant must satisfy CLAF that there are reasonable prospects of success, and that the particular circumstances of the case could also satisfy the so-called “private client test”. CLAF should have an overriding discretion to turn down an application in order to maintain the Fund’s financial viability. Any decision of CLAF to turn down an application would be subject to review by an appeal panel to be appointed by the independent board.

Mediation

7.76 It has been suggested that mediation should be incorporated into CLAF in view of its growing success and popularity, and the savings it could potentially achieve in legal costs. Mediation is regarded as the most commonly used alternative dispute resolution (“ADR”) technique, and is:

“... normally conceived of as a voluntary process in which a neutral facilitator helps the parties reach agreement. The parties decide the terms of the agreement and although mediation is a non-binding process, a signed mediated agreement is a legally enforceable contract.”³³

Benefits of mediation

7.77 There are numerous benefits that can arise from mediation, including:

- (a) **Early resolution** – Mediation can be arranged to take place within a short period of time at any stage in the proceedings. A mediation case normally concludes within a few hours to a few days, although in more complicated disputes such as construction, medical and industrial disputes, a longer time would be expected. If the case shows no prospect of settlement after a certain period of time, the mediator would advise the parties to temporarily or permanently terminate the mediation to

³³ Professor Hazel Genn, “Court-Based ADR Initiatives for Non-Family Civil Disputes: The Commercial Court and The Court of Appeal”, March 2002.

save costs.³⁴ In comparison, if a court hearing is required, usually months are required to exchange evidence and prepare the case for hearing.

- (b) **Less legal fees** – Although parties still need to prepare some evidence, the amount of preparation and time will be less than those for a court hearing. The mediation session is usually shorter than the court hearing. If, however, the mediation becomes unsuccessful, the costs of mediation might be seen as an extra burden in addition to the normal litigation costs. Proponents of mediation would answer that the unsuccessful mediation process can help to clarify and define the real issues in dispute. This should shorten the court hearing time and help parties to minimise legal costs.
- (c) **Privacy** – The mediation process is conducted between the parties in private without public observers. In contrast, a court hearing is open to the general public.
- (d) **Finality** – A mediated solution is a settlement between the parties, and so generally cannot be the subject of further appeal.
- (e) Other benefits include greater flexibility in resolving the dispute, the tension and conflict in the adversarial litigation system can be avoided and the fact that mediation enables the parties to have a better control of the outcome of the dispute.

Adverse costs order for unreasonable refusal to mediate

7.78 The Final Report of the Chief Justice's Working Party on Civil Justice Reform³⁵ proposed that, subject to the adoption of appropriate rules, the court should have power, after taking into account all relevant circumstances, to make adverse costs orders in cases where mediation has been unreasonably refused after a party has served a notice requesting mediation on the other party; or after mediation has been recommended by the court on the application of a party or of its own motion.³⁶

7.79 Since it is likely that this proposal will be implemented by legislation, it is necessary to consider how CLAF would operate in tandem with the new costs consequences of failure to mediate.

³⁴ Information from Hong Kong Mediation Centre.

³⁵ Issued in 2004.

³⁶ See Recommendation 143.

Proposed mechanism

7.80 Although the relevant rules of court have not been drawn up, it has been proposed that parties to proceedings should be able to serve notices in prescribed forms to:

- (i) request the other party or parties to participate in mediation; or
- (ii) apply to the court for a mediation recommendation.

The court should also have power to recommend mediation of its own motion.

7.81 Where a notice to mediate has been served by a party to proceedings, or where the court has made a mediation recommendation, either a refusal or failure to make a sufficient attempt at mediation would expose the party in question to the risk of an adverse costs order at the conclusion of the court proceedings.

7.82 It is envisaged that the relevant rules will spell out what conduct would constitute a sufficient attempt at mediation. As mentioned in the Final Report of the Chief Justice's Working Party on Civil Justice Reform, the rules should specify the minimum extent of participation in the mediation process required to constitute a sufficient attempt.³⁷ The rules might also specify that the notice to mediate should identify the relevant mediation institution and rules under which the proposed mediation is to take place.

7.83 When the parties to proceedings are attempting mediation, the court should, so far as possible, ensure that the timetable for the proceedings accommodates the mediation process so as to avoid incurring unnecessary parallel costs.

Proper safeguards

7.84 The relevant rules should ensure that the following attributes of mediation are preserved:

- that the mediation process should remain confidential and should proceed on a without prejudice basis;
- that any settlement is arrived at on a consensual basis;
- that parties are free to withdraw from mediation without reaching agreement.

7.85 The proposed costs sanctions should only operate where there has been an unreasonable refusal to engage in mediation either at all or to a sufficient extent, and this should be capable of being decided without inquiring into confidential or "without prejudice" communications. In situations where a

³⁷

Para 853(f).

party can provide a reasonable explanation for not participating in mediation, he should not be subject to any adverse costs order. What constitutes a reasonable refusal to mediate would be determined by the courts and guidance could be sought from jurisprudence on this point developed in England and Wales and elsewhere.³⁸

Jurisprudence in England and Wales

7.86 England has adopted similar costs sanction rules for failure to take part in alternative dispute resolution, and a body of case law has been developed. Strong support for the use of alternative dispute resolution in general, and mediation in particular, has been given by the courts in cases such as *R (on the application of Cowl) v Plymouth City Council*,³⁹ *Dunnett v Railtrack plc*⁴⁰ and *Hurst v Leeming*.⁴¹

7.87 On the issue whether a party's refusal to take part in mediation is reasonable or not, it would be useful to note that the English Court of Appeal in *Halsey v Milton Keynes General NHS Trust*⁴² has provided some guidance:

*"The question whether a party has acted unreasonably in refusing ADR must be determined having regard to all the circumstances of the particular case. ... Factors include: (a) the nature of the dispute; (b) the merits of the case; (c) the extent to which other settlement methods have been attempted; (d) whether the costs of the ADR would be disproportionately high; (e) whether any delay in setting up and attending the ADR would have been prejudicial; and (f) whether the ADR had a reasonable prospect of success."*⁴³

Mediation's interface with CLAF

7.88 If rules are drawn up such that an unreasonable refusal to make a sufficient attempt at mediation could, subject to the court's discretion, become a basis for making an adverse costs order after the conclusion of the case, then the following scenarios can arise:

- (a) On receipt of relevant information from the applicant, CLAF would assess the merits of the case and at the same time, consider the suitability of the case for mediation.⁴⁴ If CLAF

³⁸ Paras 853(i) and (j) of Final Report on Civil Justice Reform.

³⁹ [2001] EWCA Civ 1935, [2002] 1 WLR 803.

⁴⁰ [2002] EWCA Civ 303, [2002] 2 All ER 850.

⁴¹ [2001] EWHC 1051 (Ch), [2003] 1 Lloyd's Rep 379.

⁴² [2004] EWCA Civ 576, [2004] 4 All ER 920. Other relevant cases on mediation and costs consequences: *Allen v Jones* [2004] All ER (D) 466 (May); *Hickman v Blake Laphorn* [2006] All ER (D) 67 (Jan).

⁴³ Para 16.

⁴⁴ Cases not suitable for mediation include situations where parties wish the court to determine a point of law to provide a binding precedent, or to determine the true construction of an on-going

considers that the case is suitable for mediation, and the applicant is willing to try mediation, then CLAF should fund the mediation and serve a mediation notice on the other party to take advantage of the costs consequences.

If the other party refuses to mediate, then CLAF would not incur any mediation fees; if the other party agrees to mediate, then there is a good chance that the case can be brought to a conclusion without incurring litigation costs.

Even if the mediation should fail, the parties should gain a better understanding of their respective strengths and weaknesses from the mediation process, and this would help to expedite the subsequent litigation process and to reduce litigation costs.

- (b) If the CLAF-assisted litigant is served with a mediation notice by the other party, and if the CLAF-assisted litigant refuses to mediate, that might impact on his costs liability which would ultimately fall on CLAF. In such circumstances, CLAF should have the power either to discontinue funding or to modify the funding arrangements between the litigant and CLAF by, for example, adjusting the level of contribution required from the litigant or the extent of funding by CLAF.

If the CLAF-assisted litigant is willing to mediate on being served with a mediation notice, then CLAF should fund his mediation to avoid any possible adverse costs consequences.

- (c) If the CLAF-assisted litigant has received a mediation recommendation issued by the court, then the position in (b) above should also apply.

Recommendation 7

We recommend that CLAF should encourage litigants to use mediation and that, where the aided party consents to mediation and CLAF considers mediation appropriate, CLAF should fund the aided party's mediation costs. Mechanisms should be established to ensure that CLAF's practices in relation to mediation take account of the expected introduction of adverse costs orders in cases where mediation has been unreasonably refused, or there has been a failure to make a sufficient attempt to mediate, as proposed by the Final Report of the Chief Justice's Working Party on Civil Justice Reform.

long term contract, or where injunctive or other relief is required. See *Halsey v Milton Keynes General NHS Trust* [2004] All ER 920.

Types of cases to be covered by CLAF

7.89 We believe that there is still a sizeable percentage of personal injury claimants who are not eligible for OLAS and SLAS and who would benefit from CLAF. Hence, personal injury cases would be covered by CLAF provided that the applicant could satisfy the merits test and the means test.

7.90 With regard to commercial cases, we believe that CLAF should cover commercial cases in which the primary remedy sought is for damages. We intend that the term “commercial cases” should not be narrowly construed. As long as the merits test is properly applied, and given that CLAF would not be operating for profit,⁴⁵ CLAF should be empowered to devise more detailed rules as to which types of commercial cases should be excluded or included.⁴⁶

7.91 As for product liability and consumer cases, we believe that the general public and consumers would benefit from the improved access to justice offered by CLAF. Businesses should be encouraged to ensure that consumer products (especially food products) that are put on the market are safe and not defective. As shown by the figures relating to the Consumer Council’s Consumer Legal Action Fund,⁴⁷ there are a sizeable number of claimants who have valid claims but had to approach the Consumer Council’s Consumer Legal Action Fund for assistance. The Consumer Council’s Fund had to turn down a significant portion of the claims, despite the fact that the cases were well-founded, because of its limited endowment. Therefore, the Consumer Council’s Fund can only support cases that have a “demonstration effect”, can promote consumer rights and have a deterrent effect on unscrupulous business practices. Product liability and consumer cases should be given priority in the CLAF scheme.

7.92 Other types of cases which are suitable for CLAF are employment cases that fall outside the jurisdiction of the Labour Tribunal, employees’ compensation cases, probate cases involving an estate, and professional negligence cases.

7.93 As for family cases, we agree with those consultees who pointed out that defining “success” or “failure” in family cases is fraught with difficulties. Hence, CLAF should not aim to cover family cases until it is considering expansion.

7.94 With regard to defamation cases, the Sub-committee recommended in the Consultation Paper that conditional fee agreements should not be extended to defamation cases at least initially. The Sub-committee made that recommendation because the award of damages is usually not the primary remedy sought in defamation cases. The relatively low damages coupled with the high risks involved made defamation cases

⁴⁵ CLAF would be operating for “surplus” as it is supposed to a self-financing fund. See discussion relating to Recommendation 3.

⁴⁶ Examples would be intellectual property cases, and insolvency cases.

⁴⁷ The acronym of the Consumer Council’s fund is also CLAF but it should not be confused with the independent body, CLAF, covered by the recommendations. See discussion in Chapter 6.

unsuitable for conditional fee arrangements outside the CLAF environment. The Sub-committee also took into consideration the fact that defamation cases funded by private conditional fee arrangements in England⁴⁸ had led to grossly disproportionate costs, and defendants' inability to recover costs even in the event of success. Defendants, including newspapers and other media, alleged that they were subjected to the "ransom effect" and felt pressurised to settle claims.

7.95 Whilst defamation actions funded by ordinary conditional fees might in some circumstances⁴⁹ entail these undesirable side-effects, we believe that that would not apply to defamation cases funded by an independent non profit-making body like CLAF. Defamation cases would be subject to the merits test of which proportionality of costs is one element. In the event that the defendant succeeds in the litigation, CLAF would pay costs to the defendant pursuant to the costs indemnity rule. If CLAF covers defamation cases, this could ameliorate the inequality of arms between the claimants and defendants in defamation cases,⁵⁰ and would also remedy the current situation that defamation cases are not covered by the existing legal aid schemes.

7.96 Although freedom of expression is enshrined in the Basic Law, this freedom is subject to the law of defamation. The media, no less and no more than any other person in Hong Kong, are subject to the constraints of the law of defamation. The extension of the CLAF regime to defamation would not create a "chilling effect" on the media, as some would argue; the law of defamation must be respected in the same way as any other law relating to publication. Legal aid does not cover defamation cases, and if the proposed CLAF is not extended to these cases, a member of the middle-income group, for whose protection the proposed regime is intended, would be without any recourse to the courts to protect his reputation from defamatory statements. Allowing access to the CLAF regime by such a person will enable the merits of his claim to be assessed objectively and professionally by CLAF and the legal practitioners it instructs. The possible size of the recoverable damages, if relevant, would form part of that assessment. The regime will also redress the imbalance of financial capabilities between the often sizable resources of a publisher and a person with only limited means who would, absent the assistance by CLAF, be compelled to accept any damage to his reputation without the ability to seek redress.

Recommendation 8

⁴⁸ See *King v Telegraph Group Ltd* [2004] EWCA Civ 613, *Turcu v News Group Newspaper Ltd* [2005] EWHC 799 and *Campbell v Mirror Group Newspaper Ltd* [2005] UKHL 61, discussed in Chapter 4 above.

⁴⁹ In England and Wales, claimants proceeding under a conditional fee agreement can recover from the defendants a "success fee" and the ATE insurance premium in addition to normal costs under the costs indemnity rule. This rule has contributed to the unfairness faced by defendants.

⁵⁰ *Steel & Morris v UK* (Application No 68416/2001) 2005, the European Court of Human Rights held that the lack of provision of legal aid to the applicants in defamation proceedings launched against them by McDonald constituted a breach of their right to fair trial protected under Article 6 of the European Convention.

Recommendation 8

We recommend that CLAF should cover at least the following types of cases:

- **personal injury cases;**
- **commercial cases in which an award of damages is the primary remedy sought;**
- **product liability and consumer cases;**
- **probate cases involving an estate;**
- **employment cases falling outside the jurisdiction of the Labour Tribunal and employees' compensation cases;**
- **professional negligence cases; and**
- **defamation cases.**

Appeals

7.97 As for the question whether CLAF should fund any subsequent appeal, we note that under SLAS, the legally aided person would generally be funded in an appeal if the other side had lost and had lodged an appeal. However, in light of the vicissitudes of litigation, we believe that any representation on appeal should be subject to a fresh merits test.

Recommendation 9

We recommend that if a judgment or decision in a case taken up by CLAF is under appeal, then CLAF's representation of the aided person at the appeal should be contingent on his satisfying a further merits test.

Contribution rate and fees

7.98 As CLAF will be aimed at a higher income group, probably with claims of higher value, it is envisaged that CLAF should be able to charge a higher contribution rate than OLAS and SLAS. The extra income could partly be utilised in advertising and promotion activities with the aim of attracting business away from the unregulated claims intermediaries so that the public can enjoy a regulated professional service.

7.99 The contribution rate under SLAS is staged to encourage settlement.⁵¹ This mechanism works well and could be copied by CLAF. Further, with the aim of building up adequate reserves to eventually fund defendants and other worthwhile cases, the contribution rate under CLAF could be set at a higher level than those of OLAS and SLAS, but lower than that normally charged by claim intermediaries.⁵² In this way, SLAS would not be adversely affected by CLAF.

7.100 We also envisage that the initial application fee payable under SLAS would also be charged by CLAF.

Recommendation 10

We recommend that an applicant for CLAF should be charged an initial application fee. We recommend that the contribution rate payable by an applicant under CLAF should be staged to encourage early settlement, and that it should be set at a higher rate than that applying under OLAS and SLAS. The contribution rate should not depend solely on the risk factors of the case concerned, but should be decided according to the average risk of the case category in question in order to protect the fund.

Conclusion

7.101 Conditional fees are undoubtedly an effective mechanism in widening access to justice, and numerous jurisdictions have employed conditional fees with variations in details to improve access to justice and proper legal representation. In Hong Kong, it is estimated that about 30% of the households are neither eligible for assistance under OLAS nor SLAS. Conditional fees can open up the possibility of enabling the middle-income group to obtain proper legal advice and assistance. Although the circumstances in Hong Kong are that ATE insurance, an important component in a successful conditional fee regime, is not likely to be readily available, other measures should be looked at to address the problem. We hope our recommendations on expanding SLAS and on the setting up of a Conditional Legal Aid Fund would be considered by the relevant authorities and stimulate further discussion by the public.

⁵¹ 10% of the damages awarded if the case is settled after delivery of a brief to Counsel to attend trial; and 6% before that.

⁵² About 30%.

Chapter 8

Summary of recommendations

(All the recommendations in this paper are to be found in Chapter 7)

Recommendation 1: Should we allow conditional fees? (paragraphs 7.5 – 7.30)

Having regard to the likelihood that insurance to cover the opponent's legal costs should the legal action fail would not be available at an affordable premium and on a long-term basis in Hong Kong, we believe that conditions at this time are not appropriate for the introduction of conditional fees, save in the circumstances set out in Recommendations 3 and 4 below.

Recommendation 2: Expansion of the Supplementary Legal Aid Scheme (paragraphs 7.31 – 7.39)

Given the success of the Supplementary Legal Aid Scheme in widening access to justice through the payment of a portion of the damages recovered by the successful applicants, and also given the widespread support for its expansion, we recommend that SLAS should be expanded on a gradual and incremental basis by, firstly, raising the financial eligibility limits and, secondly, increasing the types of cases covered by SLAS, having regard to maintaining the financial viability of SLAS.

Recommendation 3: Setting up of a privately-run conditional legal aid fund (paragraphs 7.40 – 7.57)

We recommend that a new fund, the Conditional Legal Aid Fund ("CLAF"), should be set up together with a new body to administer the fund and to screen applications for the use of conditional fees, brief out cases to private lawyers, finance the litigation, and pay the opponent's legal costs should the litigation prove unsuccessful. We recommend that CLAF should be permitted to engage the private lawyers it instructs on a conditional fee basis, while CLAF (in the same way as SLAS) should be permitted to charge the client on a contingency fee basis. We recommend that CLAF should initially accept applications from claimants only, but the long-term goal is for CLAF to also cater for defendants after CLAF has built up adequate reserves.

Recommendation 4: Should CLAF be run by the Legal Aid Department or should it be run independently? (paragraphs 7.58 – 7.62)

We recommend that the Government should carry out a feasibility study into establishing CLAF as a statutory body under the governance of an independent board empowered by legislation to fulfil the functions set out in Recommendation 3.

Recommendation 5: Eligibility for CLAF (paragraphs 7.63 – 7.70)

We recommend that applicants for CLAF should be subject to a means test which should have a generously set upper limit, but should not have a minimum financial eligibility limit. We recommend that the feasibility study into establishing CLAF should be carried out irrespective of whether the Supplementary Legal Aid Scheme is expanded. Individuals, sole proprietors and partnerships falling within the definition of “small and medium-sized enterprises” should be eligible to apply. “Small and medium-sized enterprises” refer generally but not exclusively to manufacturing enterprises with fewer than 100 employees, and non-manufacturing enterprises with fewer than 50 employees. Applications would be considered on a case by case basis taking into consideration other factors such as financial resources. We recommend a review in due course to consider expansion to include limited companies which satisfy the “small and medium-sized enterprises” criteria.

Recommendation 6: The merits test (paragraphs 7.71 – 7.75)

We recommend that to be eligible for CLAF, an applicant must satisfy a merits test; that is, the applicant must satisfy CLAF that there are reasonable prospects of success, and that the particular circumstances of the case could also satisfy the so-called “private client test”. CLAF should have an overriding discretion to turn down an application in order to maintain the Fund’s financial viability. Any decision of CLAF to turn down an application would be subject to review by an appeal panel to be appointed by the independent board.

Recommendation 7: Mediation (paragraphs 7.76 – 7.88)

We recommend that CLAF should encourage litigants to use mediation and that, where the aided party consents to mediation and CLAF considers mediation appropriate, CLAF should fund the aided party’s mediation costs. Mechanisms should be established to ensure that CLAF’s practices in relation to mediation take account of the expected introduction of adverse costs orders in cases where mediation has been unreasonably refused, or there has been a failure to make a sufficient attempt to mediate, as proposed by the Final Report of the Chief Justice’s Working Party on Civil Justice Reform.

**Recommendation 8: Types of cases to be covered by CLAF
(paragraphs 7.89 – 7.96)**

We recommend that CLAF should cover at least the following types of cases:

- personal injury cases;
- commercial cases in which an award of damages is the primary remedy sought;
- product liability and consumer cases;
- probate cases involving an estate;
- employment cases falling outside the jurisdiction of the Labour Tribunal and employees' compensation cases;
- professional negligence cases; and
- defamation cases.

Recommendation 9: Appeals (paragraph 7.97)

We recommend that if a judgment or decision in a case taken up by CLAF is under appeal, then CLAF's representation of the aided person at the appeal should be contingent on his satisfying a further merits test.

Recommendation 10: Contribution rate and fees (paragraphs 7.98 – 7.100)

We recommend that an applicant for CLAF should be charged an initial application fee. We recommend that the contribution rate payable by an applicant under CLAF should be staged to encourage early settlement, and that it should be set at a higher rate than that applying under OLAS and SLAS. The contribution rate should not depend solely on the risk factors of the case concerned, but should be decided according to the average risk of the case category in question in order to protect the fund.

Responses to Consultation Paper on Conditional Fees

1. Administration Wing, Chief Secretary for Administration's Office
2. Aviva General Insurance Ltd
3. Ruy Barretto, SC
4. Boase Cohen & Collins, Solicitors & Notaries
5. British Chamber of Commerce in Hong Kong
6. Peter Bullock, Masons
7. C Y Chan Company, Solicitors
8. Cheng Huan SC, QC
9. Jennifer Cheung & Co
10. Chevalier Insurance Company Limited
11. Kenneth C W Chik, Counsel
12. China Life Insurance (Overseas) Co Ltd
13. Chinese General Chamber of Commerce
14. Simon C W Chiu, Barrister
15. Solomon C Chong & Co, Solicitors
16. Consumer Council
17. Dao Heng Insurance Co, Ltd
18. Department of Justice (Civil Division)
19. Department of Justice (Legal Policy Division)
20. Duty Lawyer Service
21. Robin Egerton, Barrister
22. Employees Compensation Insurer Insolvency Bureau
23. Ernst & Young
24. Federal Insurance Company
25. Federation of Hong Kong Industries
26. T C Foo, Liu, Choi & Chan, Solicitors & Notaries
27. John Ho & Tsui, Solicitors
28. Lawton M L Ho, Maurice Lee, Tsang, Ng-Quinn & Tang
29. Hong Kong Bar Association

30. Hong Kong Confederation of Insurance Brokers
31. Hong Kong Corporate Counsel Association
32. Hong Kong Family Law Association
33. Hong Kong Family Welfare Society
34. Hong Kong Federation of Electrical and Mechanical Contractors Limited
35. Hong Kong Federation of Insurers
36. Hong Kong Federation of Trade Unions
37. Hong Kong Federation of Women Lawyers
38. Hong Kong General Building Contractors Association Ltd
39. Hong Kong Institute of Architects
40. Hong Kong Institute of Certified Public Accountants
41. Hong Kong Institute of Surveyors
42. Hong Kong International Arbitration Centre
43. Hong Kong Women Professionals and Entrepreneurs Association Ltd
44. HSBC Group
45. Robert Karlson, Remedy
46. Dr Hon Kwok Ka Ki, Legislative Councillor
47. Labour Department
48. Albert Lam, Hampton, Winter and Glynn, Solicitors & Notaries
49. Simon H W Lam, Barrister
50. David Laskey, hannover life re
51. Law Society of Hong Kong
52. Polly Lee
53. Legal Aid Services Council
54. Legislative Council, Panel on Administration of Justice and Legal Services
55. Dr Paul C K Leung
56. Li & Partners, Solicitors
57. Liberal Party
58. Lo Wong Fung-ping (transliteration)
59. Ming An Insurance Co (HK) Ltd
60. Elizabeth Mo & Associates
61. George Y C Mok & Co, Solicitors
62. Motor Insurers' Bureau of Hong Kong

63. MTR Corporation
64. Ng & Shum, Solicitors & Notaries
65. Kevin Ng & Co, Solicitors
66. Ludwig Ng, Or Ng & Chan, Solicitors
67. Ngai Chu-shing
68. Office of the Commissioner of Insurance
69. Prudential Assurance Company Limited
70. Remedy (Asia) Limited
71. Royal Sun Alliance Insurance (HK) Limited
72. Gary Seib, Parnter, Baker & McKenzie
73. Sher Hon Piu, Barrister
74. Bryan Slater, Contego Ltd (UK)
75. So Chi Keung
76. Society for Community Organization
77. Sun Hung Kai Properties Insurance Limited
78. Betty Tam
79. David Ting
80. Tuen Mun District Board
81. Wan and Leung, Solicitors
82. Weir & Associates, Solicitors & Notaries
83. The Hon Mr Justice Woo, VP
84. Xiaowen Qian
85. Rowdget W Young & Co, Solicitors & Notaries
86. Zurich Group