THE LAW REFORM COMMISSION OF HONG KONG

REPORT

CONDITIONAL FEES

EXECUTIVE SUMMARY

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

Terms of reference

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

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

The Sub-committee

2. The members of the Sub-committee on Conditional Fees are:

Prof Edward K Y Chen, GBS, CBE, JP *(Chairman)*	President Lingnan University
Mr William H P Chan	Deputy Director Legal Aid Department
Mrs Pamela W S Chan, BBS, JP	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 *(Secretary from December 2005 to April 2006)*	Senior Government Counsel Law Reform Commission
Ms Cathy Wan *(Secretary except from December 2005 to April 2006)*	Senior Government Counsel Law Reform Commission

The consultation exercise

3. 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.

Conditional fees are not contingency fees

4. 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.

5. 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.

Chapter 1 – The costs of litigation

Who pays for litigation?

6. *Insurance* – Insurance companies are major participants in litigation, particularly in personal injury cases.

7. *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.

8. *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. In the United States, in the absence of legal aid, contingency fees are one of the principal sources of financing for litigation.

9. *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.

10. *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.

11. *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*". The developing trend of third party funding has been examined by England's Court of Appeal in *Arkin v Borchard Lines Ltd* [2005] 1 WLR 3055.

Relevant costs rules in Hong Kong

Costs to follow the event – the costs indemnity rule

12. In Hong Kong, the unsuccessful litigant will usually be ordered to pay the legal costs of the successful party, in addition to paying his own legal costs. This rule is referred to as the "costs indemnity rule", and is also the basic costs allocation rule for civil proceedings in the United Kingdom, Canada, Japan and most European countries. The principal exception is the United States, where the general rule is that each party must pay his or her own costs, except where the litigation is vexatious or an abuse of process.

Legal Aid as a source of finance for civil litigation

The means test

13. The means test evaluates whether an applicant's financial resources exceed the statutory limit allowed for the relevant legal aid scheme. Financial resources are taken as an applicant's monthly disposable income multiplied by 12, plus his or her disposable capital. Monthly disposable income is the difference between gross monthly income and allowable deductions, which are rent, rates and statutory personal allowances for the living expenses of the applicant or his or her dependants. Disposable capital consists of all assets of a capital nature, such as cash, bank savings, jewellery, antiques, stocks and shares and property. Excluded from the calculation of capital are, for example, the applicant's residence, household furniture, and implements of the applicant's trade. Negative equity in a real property is treated as having no value in the assessment of disposable capital.

Ordinary Legal Aid Scheme and Supplementary Legal Aid Scheme

14. To qualify for legal aid for civil proceedings under the Ordinary Legal Aid Scheme, the applicant's financial resources must not exceed $158,300. The Supplementary Legal Aid Scheme was introduced in 1984 to assist members of the so-called "sandwich class" who would otherwise be outside the means test for the ordinary scheme. 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 $4 million and $28.1 million was recovered on behalf of the aided persons.

Provisions against conditional or contingency fee arrangements in Hong Kong

15. In Hong Kong, a solicitor may not enter into a conditional or contingency fee arrangement to act in contentious business. The restriction stems from legislation, conduct rules, and common law. In *Cannonway Consultants Ltd v Kenworth Engineering Ltd*, 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 Legal Practitioners Ordinance (Cap 159) provides that the power to make agreements as to remuneration and the provisions for the enforcement of these agreements do not give validity to "*any agreement by which a solicitor retained or employed to prosecute any action, suit or other contentious proceeding stipulates for payment only in the event of success in that action, suit or proceeding.*"

Chapter 2 – Contingency fee arrangements in the USA

16. 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. Although contingency fees had opened the courthouse doors to the poor, they had attracted much criticism. 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.

Chapter 3 – Legislative changes in England concerning conditional fees

Courts and Legal Services Act 1990

17. Section 58(3) of the Courts and Legal Services Act 1990 legitimised conditional fee agreements, so that a conditional fee agreement "*shall not be unenforceable by reason only of its being a conditional fee agreement*". The Act empowered the Lord Chancellor, through subordinate legislation, after consultation with the designated judges and the profession, to prescribe the types of cases for which conditional fee agreements would be enforceable and to determine the permissible level of uplift fee on success. 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.

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

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

After-the-event insurance

18. 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). As at December 2006, there were about 30 companies advertising themselves as providers of ATE insurance, but just five were actual insurers. The rest were brokers. The ATE insurance market is not particularly stable, and ATE insurance providers enter or leave the market from time to time. Senior Costs Judge Peter Hurst has commented 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.

Further reforms 1998 – 2000

19. In 1998, a new Conditional Fee Agreements Order 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.

20. The Access to Justice Act 1999 brought about further changes. 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. The successful litigant can also recover from the losing litigant the success fee or uplift agreed between the successful litigant and his own lawyer, subject to taxing down by the Court.

21. 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. They have certainly been the source of much controversy and satellite litigation.

22. 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.

Repeal of the Conditional Fee Agreements Regulations

23. 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%. 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.

Chapter 4 – Problems and litigation in England

24. 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.

25. The case of *Callery v Gray,* (Nos 1 and 2) [2002] 1 WLR 2000-2032 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.

26. 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 seems, are the ATE premiums, especially as to the appropriate amount of ATE premiums. 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. The decision turns on whether the pre-existing BTE cover is "satisfactory" for a claim of that particular size.

27. There has been a string of case law 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) [1975] QB 373 and explained in *Awwad v Geraghty & Co*. [2000] 3 WLR 1041. 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".* Hence, unless a conditional fee agreement fully complies with the relevant legislation which sanctioned conditional fees, the conditional fee agreement would not be enforced.

28. 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. Some 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. Some believed that the problems would continue to manifest themselves under the revised conditional fee regime.

29. 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.

<u>Chapter 5 – Outcome-related fees in other jurisdictions</u>

Australian jurisdictions

30. The Australian Law Reform Commission explained that all Australian jurisdictions permit lawyers to charge on a speculative fee basis to recover a fixed agreed sum if the proceedings turn out to be successful. More commonly, however, a fixed sum and a percentage uplift of the usual fee would be adopted. Unlike the United States, contingency fees calculated as a percentage of the sum awarded by the court are not permitted in Australia. With regard to uplift fees, the rules vary in different states of Australia and the uplift fees range from 25% to 100%.

Canadian jurisdictions

31. 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, 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. Canadian jurisdictions adopt the costs indemnity rule, but there is no ATE insurance available. 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.

Ireland

32. 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 reported that conditional fees are seldom used in Ireland.

33. Contingency fees are prohibited, but a detailed analysis 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

34. The *Management Measures of Fee Charging for Lawyers' Services* (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;

(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

35. In Northern Ireland, under the Access to Justice (Northern Ireland) Order 2003 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 mechanism 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. Northern Ireland recently conducted research on the establishment of a Contingency Legal Aid Fund ("CLAF"). It was suggested that the fund would be established with public money and be limited to certain "*standard category cases, for example, road traffic accidents*", with a high success rate so that there "*would not be a substantial drain on the fund*". It seems, however, that Northern Ireland's review does not offer sufficient protection to defendants. It was decided that the CLAF would not meet the legal costs of the winning defendant; whereas if the defendant lost, the defendant would have to pay normal costs to the claimant, plus an additional levy to the CLAF.

Scotland

36. In Scotland, while civil legal aid is still available lawyers have been allowed to act on a speculative basis. The speculative action is usually an action for damages for personal injury. The solicitor and the advocate

undertake to act for the pursuer (plaintiff) on the basis that they will not be remunerated except in the event of success and that any costs such as court fees will be defrayed by the solicitor.

37. 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.

South Africa

38. 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.

Chapter 6 – Arguments for and against conditional fees and related issues

39. The literature on conditional fees identified various arguments against the introduction of conditional fees. They are:

- the risk of conflict of interest and unprofessional conduct,
- increase in opportunistic and frivolous claims,
- excessive legal fees,
- reliance on legal expenses insurance, and
- satellite litigation.

40. 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:

- ensure access to justice,
- spread the financial risk involved in litigation,
- weed out frivolous or weak claims,
- allow consumers to choose and promote freedom of contract,
- align lawyers' interests with those of the client, and
- harmonise the fee structure of Hong Kong with that in other jurisdictions.

Other related issues
Claims intermediaries

41. 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.

42. 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. This resulted in the enactment of the Compensation Act 2006 which makes provision for the regulation of claims management companies.

Operation of claims intermediaries in Hong Kong

43. 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, 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.

44. 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.

Litigants in person

45. 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. 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 referred 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%
-	Other reasons: lack of trust of lawyers or legal representation not allowed by legislation	7%

46. 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.

47. 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.

Consumer Council's Consumer Legal Action Fund

48. 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") provides figures on this. 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. 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 "demonstration" effect. According to the Consumer Council, the aggregate number of potential claimants involved in the "with merits" groups would be between about 140 and several hundred.

Chapter 7 – Proposals for reform

The Sub-committee's consultation paper

49. 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. However, the proposed structure of the conditional fees regime should differ from that in England in a number of ways.

- 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), the Sub-committee recommended that consideration should be given to setting up an independent body which the Sub-committee named "the Contingency Legal Aid Fund". 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.

Views on the proposed conditional fees regime

50. 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.

51. 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.

52. These disadvantages should, however, be balanced against the improvement in terms of access to justice, especially for the middle income group. Access to justice is one of the fundamental rights constitutionally protected by the Basic Law. If some segments of society cannot afford to pay legal costs, they are to some extent deprived of the right of access to justice. 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.

53. 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 the 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.

Problems with ATE insurance in England

54. 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" 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 …."*

Prospects of ATE insurance in Hong Kong

55. 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 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.

56. Given that there are over 180 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.

57. 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. For the average citizen who has limited assets 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

58. 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. 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.

59. The Government's stance in rejecting the expansion of SLAS was based mainly 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.

60. 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.

61. 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. 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 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

62. 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.

63. 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, 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.

64. 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. 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.

65. Also, given the features of the proposed conditional legal aid fund, 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. 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.

66. Further, allowing only a conditional legal aid fund to employ conditional and contingency fees 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?

67. 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 alike. However, 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. 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?

68. 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.

69. 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.

70. 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.

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

71. 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.

72. 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 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

73. 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 qualify of legal services.

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.

The merits test

74. 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.

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

75. 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. 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. 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 save costs.

(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.

(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.

Proposed mechanism

76. 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.

77. 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 to mediate, or a 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.

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.

Types of cases to be covered by CLAF

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

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

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

78. 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.

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