THE DAMAGES-BASED AGREEMENTS REFORM PROJECT

DRAFTING AND POLICY ISSUES

August 2015

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MEMBERS OF THE WORKING GROUP

The Working Group for the Damages-Based Agreements Reform Project consists of the following:

1. Professor Rachael Mulheron (Chair, and CJC member)
2. Mark Friston (Bar Council representative)
3. David Greene (Law Society representative)
4. Stuart Kightley (Assn of Personal Injury Lawyers (APIL) representative)
5. Maura McIntosh (Herbert Smith Freehills, commercial litigator)
6. Hardeep Nahal (Commercial Litigation Forum representative)
7. Andrew Parker (CJC member)
8. Nick Parsons (Forum of Insurance Lawyers (FOIL) representative)
9. Peter Smith (CJC member)
10. David Taylor (Employment Lawyers Assn (ELA) representative)

Robert Wright (Head of Policy, Civil Litigation Funding and Costs) , together with lawyers from the Ministry of Justice with experience of drafting Regulations, variously attended the Working Group's meetings, as observers. The Secretariat was provided by the CJC.

TERMS OF REFERENCE

It was envisaged that the Working Group will operate in two stages.

First, the Working Group will make recommendations to the Government, regarding revisions to the Damages-Based Agreements Regulations 2013 (where such revisions would be feasible within the parameters of current Governmental policy), and in particular on whether the regulations could be made more effective by some improvements, including (but not limited to):

- dividing into two sets the existing regulations, with those for employment tribunals (as per the 2010 regime) separated from regulations for civil litigation proceedings;

- clarifying that different forms of litigation funding cannot take place at the same time, although they could do so at different stages of a case;

- changing the regulations such that defendants will be able to use DBAs, by widening the application of the regulations where a party receives a specified financial benefit (rather than restricting the availability of DBAs to where a monetary payment is received);

- clarifying that the lawyer's payment can only come from damages, and that the payment should be a percentage of the sum ultimately received (not awarded or agreed); and

- reviewing whether the regulations should contain provisions governing the termination of a DBA.

Secondly, and as part of the CJC's function to keep the civil justice system under review, the Working Group will consider relevant areas of policy governing the operation and utility of damages-based agreements, with a view to informing the Government of particular policy matters which may be worthy of review, either preceding or following the 2015 DBA Regulations taking effect.

PREFACE

The commission from the Government

By letter dated 30 October 2014, from Lord Faulks QC to Lord Dyson Master of the Rolls, Lord Faulks sought the assistance of the Civil Justice Council upon the issue of how the regulatory framework applying to damages-based agreements could be improved, in specific respects. A set of draft Damages-based Regulations were provided to the CJC Working Group to review for that purpose. These issues form the basis of the Terms of Reference outlined previously.

In particular, the Government's intention is 'substantively to improve the regulatory framework without encouraging more litigation', and that the overriding objective is 'to ensure that any changes we make do not encourage litigation which would not otherwise be taken forward. Given the similarities in substance between DBAs and CFAs, [the Government] do[es] not see DBAs are filling an access to justice gap — rather, they are intended to be an alternative form of funding, perhaps in niche areas of litigation.' In stating this, however, Lord Faulks acknowledged that it was a 'complex issue', and that the Government was keen to avoid, so far as was possible, the 'unintended consequences' that may flow from the redrafting of the DBA Regulations.

With that in mind, the Working Group members have sought to canvass (and this Report has sought to capture) a wide range of points that may arise per issue, so that the Government may be aware of these various points and uncertainties, when considering the way forward.

To emphasise, it is not the Working Group's remit from the Government to draft suitable Regulations in draft. However, the Working Group has sought to illustrate some of its recommendations in an amended suggested set of Regulations (contained in Appendix 1), and holds itself at the ready to assist with the redrafting task, if requested.

Phase I

The Working Group was asked to make recommendations to the Government on a draft version of the Damages-Based Agreements Regulations 2015 (hereafter, 'the 2015 DBA Regulations'), in respect of specific drafting technicalities which have arisen in commentary and debate to date. There have been approximately 20 particular issues mentioned in despatches, prior to and since the 2013 Regulations were implemented on 1 April 2013, and these are set out in Phase I of this Report.

For each drafting issue, the Report sets out:

- ❑ the issue in a nutshell;
- ❑ the discussion points arising in the Working Group's meetings; and
- ❑ the Working Group's recommendations.

As will be evident, there are numerous drafting issues that are worthy of consideration, quite apart from the vexed, and well-publicised, issue of 'hybrid DBAs'.

This is the primary task with which the Working Group was commissioned. This Phase I work was undertaken via a series of five meetings of the Group which were held December 2014–February 2015, with the report itself completed in March 2015.

To clarify, the 2015 DBA Regulations will **not** apply to DBAs in respect of employment matters. Those will be subject to the Damages-Based Agreement (Employment Matters) Regulations 2015, which will be similar to the 2010 DBA Regulations (which only applied to employment matters). Under the 2015 DBA Regulations, an '*employment matter' means a matter that is, or could become, the subject of proceedings before an employment tribunal*' (per Reg 1(2)). According to Reg 1(4)(b), the 2015 Regulations do not apply to an employment matter.

Requests for attendance

For the purposes of the Phase I study, the Working Group invited representatives from Harbour Litigation Funding and from Burford Capital to its meeting on 27 January 2015, in order to obtain a clearer understanding of what 'hybrid DBA' products are offered by these Funders. It was thought that a better appreciation of how these models worked was necessary, to determine whether they would possibly infringe the provisions of the 2015 DBA Regulations. Each Funder had obtained legal advice that their hybrid DBA complied with the 2013 DBA Regulations, and hence, any change to that status, via the 2015 Regulations, would be sure to be controversial.

The Working Group found the attendance of the Funders to be helpful and illuminating. The results of the Funders' input are included in the discussion of issue 9.

Phase II

Whereas the Phase I study focused upon technical drafting issues, on which the Working Group made recommendations to the Government regarding potential revisions to the Damages-Based Agreements Regulations 2013 (where such revisions would be feasible within the parameters of Governmental policy), the Phase II work concentrated upon aspects of that Governmental policy. This part of the Damages-Based Agreements reform project has been undertaken, as part of the Civil Justice Council's statutory functions which are contained in s 6(3) of the Civil Procedure Act 1997, *viz*:

> *(a) keeping the civil justice system under review, and*
> *(b) considering how to make the civil justice system more accessible, fair and efficient.*

In the CJC's view, some aspects of DBA policy which have been adopted or endorsed by the (former Coalition) Government have given rise to sufficient disquiet or opposition in the legal marketplace to warrant some further consideration by policy-makers. By revisiting these relevant areas of policy, the purpose of this part of the Working Group's DBA project is to inform, or to reiterate to, the new Government those particular policy views which may be worthy of review, during the course of drafting the foreshadowed 2015 DBA Regulations.

This Phase II work was undertaken throughout the Working Group's five meetings held over the period of December 2014–February 2015, and with a further meeting which was dedicated solely to policy issues held on May 2015.

To clarify, the Working Group did **not** consider the following:

i. any policy issues that may arise specifically out of the forthcoming Damages-Based Agreement (Employment Matters) Regulations 2015. The operation of DBAs, insofar as they apply to employment matters, will lie outside the scope of the foreshadowed 2015 DBA Regulations which the Working Group has been asked to consider. Employment DBAs were formerly covered by the DBA Regulations 2010 (which were revoked when the generalist 2013 DBA Regulations came into effect on 1 April 2013), and clearly comprise a dedicated and specialist area. Hence, the Working Group's comments on policy issues contained herein are addressed to civil litigation more generally;

ii. any policy issues associated with the non-application of DBAs to opt-out collective actions. As evident in Appendix 1, that s 58AA(11) of the Courts and Legal Services Act 1990 provides that s 47C(8) of the Competition Act 1998 overrides the provisions of s 58AA — and s 47C(8) provides that, '*[a] damages-based agreement is unenforceable if it relates to opt-out collective proceedings.*' Given that this recent reform (enacted in Sch 8 of the Consumer Rights Act 2015, passed 26 March 2015) was a initiative of the Department for Business, Innovation and Skills, rather than of the MOJ, the Working Group considered that it was inappropriate to consider the policy issues relevant to collective redress during this reform project.

GLOSSARY AND TERMINOLOGY

Glossary

The following abbreviations are used throughout this Report:

C	Claimant/s
CFA	Conditional fee agreement
CJC	Civil Justice Council of England and Wales
CLSA 1990	Courts and Legal Services Act 1990
CMC	Claims management company/ies
CPR	Civil Procedure Rules 1998
D	Defendant/s
DBA	Damages-based agreement
MOJ	Ministry of Justice
reg	Regulation

The 'Ontario model' versus the 'success fee' model

Given the importance of the distinction between the so-called 'Ontario model' and the 'success fee model', which underpins much of the discussion in this Report, a brief summary of the difference between the models may be useful for the reader. The difference largely turns upon the treatment of recoverable costs.

The DBA Regulations implemented thus far in England and Wales reflect the Ontario model (albeit that there are numerous differences between the English version, and that which applies in Ontario, so as to render the regimes entirely disparate). To highlight the difference between the two models, using a very simple example to illustrate:

- Suppose that solicitor (S) and client (C) enter into a 25% contingency fee agreement;
- C succeeds in his claim, and recovers £100,000 in damages from defendant (D);

- ❑ C's recoverable *inter partes* costs are assessed at £20,000.

How much is C entitled to recover in this scenario?

Under the Ontario model: £95,000. The recoverable fees are to be deducted from the contingency fee, so that the most that S can retain, in the event of success, is the contingency fee cap of £25,000. Under this model, S retains the recoverable costs of £20,000, and he can take a further £5,000 from the damages awarded to C, to make up the shortfall to reach the 25% contingency fee cap. S will recover £25,000; and C will retain the balance of £95,000 of the damages awarded.

Under the success fee model: £75,000. The contingency fee is to be treated as the success fee, which can be retained by S, on top of the recoverable costs awarded. Hence, S would be entitled to receive the £25,000 contingency fee, as well as the £20,000 of recoverable costs. That would mean that S recovered £45,000 in total; and C would retain £75,000 of the damages awarded.

DRAFTING ISSUES

1. ITEMS WITHIN THE DBA CAP

The issue

The client is liable to pay **two** sums under a DBA, according to Reg 4(1) of the 2015 DBA Regulations — the '*representative's payment*', plus '*expenses incurred by the representative*'. What is included within the representative's payment, thus 'eating away' at the contingency fee earned by the solicitor, has been controversial.

Discussion points

1. The client is liable to pay **two** sums under a DBA, in the event that the client obtains a '*financial benefit*' under the agreement:

The DBA fee itself (and the things inside that cap)
the 'representative's payment', net of: ★ recoverable costs; and ★ counsel's fees *Reg 4(1)(a)*

PLUS:

The expenses (which fall outside the cap)
'any expenses incurred by the representative' *Reg 4(1)(b)* Hence, expenses must be paid for by the client, in addition to the DBA fee.

2. The fact that recoverable costs are within the DBA cap was a Governmental policy decision which was implemented in the 2013 DBA Regulations, and that has been carried forth in the 2015 DBA Regulations. Whether that is an optimal situation is not an appropriate subject matter for Phase I of the project — involving, as it does, a key policy decision to implement the 'Ontario' rather than the 'success fee' model. That topic falls under Phase II of the project.

3. Under the 2013 DBA Regulations, counsel's fees were within the cap for all matters other than employment matters. That position remains the case under the 2015 DBA Regulations. However, whether counsel's fees **should** be within the cap, or should indeed be outside the cap (i.e., treated as an 'expense', to be paid in addition to the DBA fee), was revisited by the Working Group, because of **four** key concerns about those fees being inside the cap:

i. In reality, the current policy decision means that counsel will either be operating on a DBA himself (which presumably, when combined with the solicitor's DBA, must not exceed the relevant statutory cap); or counsel's fee will be paid for out of the cap as a disbursement (where the amount of that disbursement cannot exceed the DBA cap). Either way, the solicitor and counsel are 'competing' for a limited pot of money. This may give rise to actual or perceived conflicts of interest between solicitor and counsel. If counsel is being paid as the case goes along, then interlocutory hearings will consume some of that 'pot' — but a major dent in the DBA fee cap will be made by counsel's fees which are incurred at trial. Hence, the solicitor may be incentivised to settle **before** trial. Although there may be an inducement to always settle to avoid costs, the problem is exacerbated where both solicitor and counsel share a limited pot of money.

ii. There is a problem regarding the uncertainty about the size of the counsel's fees, particularly in a drawn-out commercial matter. The amount that will be consumed by counsel's fees will likely not be known when the DBA is actually entered into. This means that the solicitor's 'return', if acting on a DBA, is an unknown quantity, because counsel's fees will need to be paid out of that contingency fee cap.

The only way around this uncertainty is to require counsel to act on a DBA too (each solicitor and counsel then taking a pre-determined percentage of the '*financial benefit*

obtained by the client'). If counsel is unprepared to act on a DBA (and that reluctance seems likely, at least in the current environment), then it will be a stark disincentive to a solicitor entering into a DBA. Practically speaking, it would be difficult for counsel to work under a DBA in a long-running commercial case — representing a year or more, unpaid, out of his diary. Members of the Working Group also pointed out that, in personal injury claims, and in lower-value commercial cases involving SMEs or competition law grievances, then treating counsel's fees as being within the cap was 'fanciful' — if this was required, then those cases may not be brought at all.

iii. There is one other option, apart from counsel acting under a DBA, or being engaged by the solicitor on a disbursements basis. The Working Group considered what would occur where counsel is paid directly by the client, and not via an engagement between solicitor and counsel. The client is entitled to agree to pay counsel direct, under payment basis C or D of the CLLS/Combar General Terms and Conditions for the Supply of Legal Services by Barristers to Solicitors in Commercial Matters. Whether counsel's fee, in that case, should be within the cap, or outside of it, is not clear on the face of the drafting in the 2015 DBA Regulations.

That sort of payment would technically not be an '*expense*' as that is currently defined in Reg 1(2), as it is not a 'disbursement incurred *by the representative*'. It is incurred by the client. However, arguably, the payment to counsel, if counsel entered into a direct agreement with the client, would nevertheless fall outside the contingency fee cap, and hence, would be treated *as the equivalent* of an 'expense'. This is because counsel's fees are **only** within the contingency fee cap (as the 2015 DBA Regulations are presently drafted), if there is a '*disbursement incurred by the representative in respect of counsel's fees*' (per Reg 1(2), per the definition of the '*representative's payment*'). However, as mentioned, where counsel is directly engaged, this is not a disbursement incurred by the solicitor, it is incurred by the client.

Moreover, it seems proper, from a policy point of view, that this direct engagement of counsel by client should not be within the contingency fee cap, as any such arrangement would be well outside the solicitor's control — and hence, it would be unsatisfactory if the

solicitor's return under the DBA cap was reduced, because of arrangements over which the solicitor had no say or control.

However, if the above interpretation is correct, then the upshot is that a solicitor could foreseeably encourage his client to do direct deals with counsel, so as to remove counsel's fees from the DBA cap. It would be startling if the drafting of the 2015 DBA Regulations encouraged practices designed to 'get around' the issue of counsel's fees being within the contingency fee cap, so that counsel's fees were not being incurred by the solicitor as a disbursement. Also, that outcome — whereby direct arrangements between clients and counsel were favoured by solicitors, to remove counsel fees from the contingency fee cap — would add another layer of complexity in negotiations with counsel, because counsel would always prefer to have recourse *to the solicitor* for payment, and not to the client.

iv. There is also a separate problem associated with counsel's fees (as with all expenses), driven by the drafting of Reg 3(2)(d)(ii)(bb) — i.e., that the legal representative is potentially 'on the hook' for payment of those expenses, and not the client, if the client does not obtain **any** financial benefit in the claim or proceedings. In particular, Reg 3(2)(d)(ii)(bb) provides that the DBA has to specify that the representative's costs, expenses, etc, will not be payable, if the client does not receive any of the financial benefit stated in the agreement. This means that, where a solicitor enters a DBA, but nothing is recovered under that DBA, then the solicitor is now potentially liable for all expenses, and not just for counsel's fees. This may induce a solicitor to arrange for a client to instruct counsel, and experts, directly, to avoid the risk of 'being on the hook' for those expenses in a scenario where nothing is recovered by the client under a DBA. This vexing issue is also dealt with in Section 20.

4. Given the problems outlined above, the Working Group considered whether a DBA statutory cap for a commercial matter should be specified for, say, 50% if counsel is not engaged; but that the cap could increase to 60–65% if counsel is engaged. However, there was concern that any circumstance in which a client could potentially lose more than half of its damages, via a DBA, may be politically unpalatable, and that such a solution seemed most unlikely.

5. It necessarily follows, from a recommendation that counsel's fees be an expense outside of the DBA cap, that a solicitor may enter into a 50% DBA (for commercial matters), and when that is added to counsel's fees, the client may ultimately pay to his legal representatives more than 50% of the damages obtained. However, for the reasons articulated above in para 3, the Working Group considered that, on balance, the better view was that counsel's fees should be treated as an expense, outside of the cap. It would always be open to a client, where counsel's participation was very likely (and was likely to be on recurrent basis), to negotiate a lower cap for the DBA which was entered into with the solicitor.

Recommendations

1.1 The Working Group recommends that, for reasons of practicality and workability, the drafting of the 2015 DBA Regulations should be amended, such that counsel's fees should **always** be treated as an '*expense*', i.e., outside the cap. (However, this should be read subject to recommendation 14.1, so that solicitor + counsel's DBAs do not exceed the statutorily-set DBA cap.)

1.2 The concern about the drafting of Reg 3(2)(d)(ii)(bb) prompted the Working Group to recommend that Reg 3(2)(d)(ii)(bb) be deleted from the Regulations.

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2. 'EXPENSES' (i.e., ITEMS FALLING OUTSIDE THE CAP)

The issue

An expense must be paid by the client to the solicitor in addition to the DBA fee — and conversely, anything paid to the solicitor which does not constitute an expense must be included within the DBA cap. This section considers what falls outside of the cap, whether on the face of the 2015 DBA Regulations, or implicitly. Under Reg 1(2), '*expenses' means disbursements incurred by the representative, including the expense of obtaining an expert's report, but excluding counsel's fees'*. Moreover, *'representative's payment' ... excludes expenses, but where relevant, includes any disbursements incurred by the representative in respect of counsel's fees.*' The issue of counsel's fees, and whether they should fall inside or outside of the cap, has already been considered in Section 1. This section of the Report considers other 'expenses'.

Discussion points

1. Experts' fees are expressly stated to be an expense under Reg 1(2), and hence, are outside the DBA cap. The Working Group considered that these were properly categorised as '*expenses*'. Consideration was given as to whether that particular example should be deleted from the 2015 DBA Regulations, and put in the Explanatory Memorandum only. However, that was not favoured, as an example in the statute itself was considered to be helpful, and not everyone reads the EM in any event.

2. However, the Working Group considered that the definition of an 'expense', in Reg 1(2), to include 'the expense of obtaining an expert's report', should be altered. When a client engages an expert, there are a number of expenses associated with that task, other than writing the report — experts may meet to agree between themselves a schedule of issues; there may be other meetings between them; and there is probably a fee for the court appearance/s.

3. The Working Group noted that the 2015 DBA Regulations are **silent** about a number of matters which may arise for consideration, as to whether they are an 'expense', to be paid in addition to the DBA fee. In that regard, the Working Group considered whether the 2015 DBA Regulations should explicitly state what items were to be treated as 'expenses'. As noted above, currently, only expert's reports are expressly stated to be an expense, i.e., outside the cap, in Reg 1(2). Nothing else in the inclusive definition in Reg 1(2) is specified to be an expense. However, under the 2013 DBA Regulations, court fees were referred to as an expense, in the Explanatory Memorandum, which is presumably still the case (and notably, post-April 2015, these may represent a very significant expense to the client). Also, presumably the costs of transcripts and translations would be 'expenses' too.

On balance, the Working Group considered that an exhaustive list of 'expenses', falling outside the DBA cap, was **not** warranted, as it would need updating, and would require exhaustive definition, neither of which was an attractive option

4. Additionally to expenses incurred by the legal representative (such as the expert's expenses, noted previously), there will be expenses which may be incurred by the client himself. For example, an ATE premium is technically payable by the claimant (client) — and with no prospect of recovering that premium from the losing defendant, post-1 April 2013. Similarly, regarding a Funder's fee under a Litigation Funding Agreement, that will likely be payable by the client, and not by the solicitor. In that case, these are **not** 'disbursements incurred *by the representative*', as required by under Reg 1(2), and hence, not an '*expense*' as currently defined. They are expenses of the client's.

In light of these examples, the Working Group considered whether the drafting of '*expenses*' should be revised in Reg 1(2), to mean 'disbursements incurred by the representative *or by the client*'. That would mean that anything incurred by the client (re an ATE premium, a Funder's fee, or anything else which bypasses the solicitor as a disbursement) would be outside the DBA cap. However, this suggestion was ultimately discounted, because the Working Group was of the view that that was **already** the effect of the 2015 DBA Regulations, as drafted. That is, ultimately under a DBA, the client is liable to pay:

i. the DBA fee;
ii. any expenses incurred by the legal representative, such as an expert's report; and
iii. any expenses incurred by the client directly, such as an ATE premium.

5. The Working Group also favoured that the term, 'expenses', should be deleted altogether from the 2015 DBA Regulations, with reference only to 'disbursements', which has an acknowledged and tested meaning.

Recommendations

2.1 The Working Group recommends that, in Reg 1(2), the example of the 'expert's fees' should be retained. However, it would be desirable for the wording to change, as follows (shown in italics):

'disbursements' means disbursements incurred by the representative, including *any fees paid or payable to an expert*, and counsel's fees

2.2 The Working Group recommends that the term, 'expenses', should be deleted from the 2015 DBA Regulations, wherever occurring, and replaced with the term, 'disbursements', which has a widely accepted meaning.

2.3 An exhaustive list of expenses/disbursements was not warranted in the 2015 DBA Regulations.

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3. THE TREATMENT OF VAT

The issue

VAT is expressly included within the DBA cap. Where VAT is payable by the client, it eats into the legal representative's recovery of a success fee, if the case is won. The query arises as to whether this was an appropriate scenario in all cases. The treatment of VAT is noted in the following provisions in the 2015 DBA Regulations: re personal injuries, '*a damages-based agreement must not provide for a representative's payment above an amount which, including VAT, is equal to 25% of the combined sums in [other Regulations]*' (per Reg 4(2)(b); and re commercial matters, '*a damages-based agreement must not provide for a payment above an amount which, including VAT, is equal to 50% of the financial benefit obtained by the client*' (per Reg 4(4)).

Discussion points

1. The position re VAT remains entirely unchanged from the previous drafting under the 2013 DBA Regulations. Of course, VAT will not eat into the legal representative's amount of contingency fee earned by the legal representative, if VAT is not payable (e.g., by international clients). However, where it is payable, it is within the DBA cap. The Working Group considered whether that situation was optimal.

2. Arguments <u>against</u> VAT being in the cap included the following:

- where a commercial client is able to reclaim the VAT paid, then it seems illogical to include VAT within the cap at all. VAT affects different clients in different ways, depending upon whether they are VAT-registered, and whether they are onshore or offshore;

- in personal injury claims, which have a statutory cap of only 25%, it effectively meant that a 25% cap is, in reality, a 20.8% cap, if VAT were included in the cap. This rendered DBAs for personal injury claims even more untenable and unworkable for the legal representative; and

- the fluctuating level of VAT, since its introduction — and the likelihood of the VAT percentage increasing, rather than decreasing, in the future — meant that its inclusion within the cap rendered the ultimate amount recovered by the solicitor less and less, as each VAT increase took effect. It was a component over which the solicitor had no control at all, but which affected the profitability of acting on a DBA basis, particularly in non-commercial matters, where the cap was substantially lower than 50%.

3. Arguments in favour of VAT being within the cap included the following:

- the cap on the CFA success fee for personal injury claims includes VAT, and hence, for the sake of consistency, it should remain in the cap for DBAs (although this point should be caveated with the note that, with a CFA, the success fee payable in addition to the recoverable costs, whereas, as discussed under Section 1, a DBA cap includes recoverable costs);

- if VAT were to be included in the cap for personal injury claims, then because that sort of client could not reclaim it (because they are individuals and the end-payers at the end of the VAT chain), and for the sake of consistency and equivalent outcomes, VAT should be included in the cap for those commercial claims where it cannot be reclaimed by the client too;

- if VAT were not in the cap, then for a commercial case where the VAT could not be reclaimed, a 50% cap + VAT was effectively a 60% cap, which meant that the client C may not recover even half of the damages obtained in the litigation (a politically-unpalatable notion?). However, it should be noted that, in such a case, C would obtain the recoverable costs as the successful party, which would partly offset the fact that VAT was outside the cap;

- VAT being within the cap provided certainty for the client, in that the client 'knew what they were getting', and it was more understandable to the client.

Recommendations

3.1 The Working Group considered that, on balance, VAT should remain within the cap, where that VAT was not recoverable by the client. Otherwise, where VAT is recoverable, then VAT should

be excluded from the cap. Appropriate adjustments to the drafting should reflect this, such that the situation regarding VAT was rendered absolutely certain, from the client's perspective.

3.2 The Working Group also noted that the phrase, 'representative's payment' is used in Reg 4(2)(b) and in Reg 4(3), but the word 'payment' is used in Reg 4(4). It recommends the use of 'representative's payment', in Reg 4(4), given that the phrase has a defined meaning in Reg 1(2).

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4. A PERCENTAGE OF 'WHAT', IN COMMERCIAL MATTERS

The issue

This drafting point revolves around a simple question: does the calculation of the percentage of the '*financial benefit obtained*' exclude, or include, recoverable costs? Under the 2013 DBA Regulations, for commercial matters, '*a damages-based agreement must not provide for a payment above an amount which, including VAT, is equal to 50% of the sums ultimately recovered by the client*' (per Reg 4(3)). That opened up the possibility that the sums recovered by C could actually include the recoverable costs awarded against D.

Discussion points

1. On this point, the drafting of the 2015 DBA Regulations has substantially changed. Under Reg 4(4), '*a damages-based agreement must not provide for a representative's payment above an amount which, including VAT, is equal to 50% of the financial benefit obtained by the client*'. Furthermore, in Reg 1(2), the term, *'financial benefit'*, is defined as:

> *(a) includes money or money's worth; and*
>
> *(b) excludes–*
>
> *(i) any costs (including fixed costs);*
>
> *(ii) any sum in respect of disbursements incurred by the representative in respect of counsel's fees; and*
>
> *(iii) any expenses incurred by the representative.*'

It is clear, from the re-drafting of '*financial benefit*' in Reg 1(2), that the DBA percentage can **only** apply to the money recovered by way of damages, or money's worth, and **cannot** attach to costs, disbursements or expenses that are recoverable from the losing opponent. That re-drafting clarifies the previous uncertainty about that point. It means that, by virtue of the 2015 DBA Regulations, any DBA which enables the DBA

fee to be calculated as a percentage of **both** the financial benefit and the recoverable costs from the other side is prohibited.

The Government provided the following example of how the new provision would work: suppose that D pays C damages of £5,000; and recoverable costs of £2,000. The DBA percentage attaches only to the £5,000 of damages, and is not calculable on the entirety of the £7,000 recovered.

2. However, the new definition of '*financial benefit*' in Reg 1(2) caused the Working Group some concerns, principally the definition of what is **excluded** from the term, '*financial benefit*'. Those concerns were three-fold:

i. the reference to 'costs', as something excluded from '*financial benefit*', brings into play the definition of 'costs' in Reg 1(2) — yet how 'costs' is defined there is unclear and confusing, referring only to time x hourly rate, quite a different concept of 'costs' than exists under CPR 44.1 (which defines costs inclusively, not exhaustively). It was not clear to the Working Group why 'costs' should be defined as it is in Reg 1(2), or indeed, why it needs to be defined at all, given that it has a clearly-understood meaning, both for the purposes of these 2015 DBA Regulations and more widely;

ii. the reference to '*fixed costs*', in what is excluded from '*financial benefit*', is also confusing, as it is inconsistent with the definition of 'costs' in Reg 1(2); and

iii. the reference to counsel's fees in what is excluded from '*financial benefit*' brings back into play the problem of what should happen, if the client directly engages counsel under payment basis C or D of the CLLS/Combar terms.

Hence, a safer exclusion from '*financial benefit*' (i.e., the thing that should be excluded from financial benefit, when considering the question, a percentage of what), would be to redraft the exclusion clause entirely. The Working Group also considered that the definition of 'costs' should be deleted from Reg 1(2) altogether.

Recommendations

4.1 The definition of '*financial benefit*' in Reg 1(2) should be redrafted to read as follows (with the redrafting in bold):

'financial benefit' –

(a) *includes money or money's worth; and*

(b) *excludes* ***any sum in respect of the client's legal fees, costs or disbursements which has been paid or is payable by another party to the claim or proceeding.***

4.2 The definition of 'costs' in Reg 1(2) should be omitted from the 2015 DBA Regulations.

***

5. RECOVERABILITY — THE EFFECT OF SET-OFFS, COUNTERCLAIMS, AND DEFENCES (TOTAL OR PARTIAL)

The issue

The intention of the DBA Regulations appears to be that the DBA fee is not calculated on what is **awarded** by way of judgment, but only on what is **recovered** by C. Under Reg 1(2), *'representative's payment' means that part of any financial benefit* obtained *in respect of the claim or proceedings that the client agrees to pay the representative'*. Similarly, the various DBA caps in Reg 4 refer to a percentage of the '*financial benefit* obtained *by the client*'. However, it is not clear that this wording is, in fact, effective to restrict the DBA payment to a percentage of the monies actually recovered. In some scenarios involving a counterclaim brought by D, for example, it is entirely unclear whether any '*financial benefit*' is obtained by C, and what the DBA fee should be in that case. (This Section concentrates upon the 'financial benefit' from **C's** point of view; whereas the complexities which surround the meaning of a 'financial benefit obtained' where a DBA is being used **by D** are discussed in Section 6.)

Discussion points

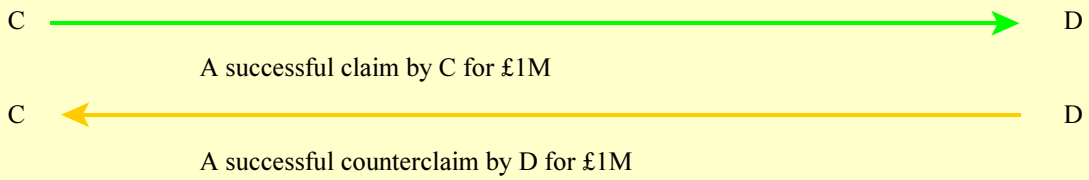
1. It appears that the intention that the DBA fee should only apply to those damages recovered, rather than to those awarded, was a policy decision of the Government's which was intended to protect C. That is, if it is not possible for client C to recover all of the damages that are awarded in C's favour, and if C is advised, and eventually agrees, to settle for a lesser sum, C should not have to pay a percentage, based on the higher figure previously awarded.

On the other hand, that policy decision does expose the legal representative to a risk, in that if client C refuses to instruct that solicitor to enforce the judgment sum, then that solicitor may be out-of-pocket. The Working Group noted the Government's position that this is a risk to be faced by the solicitor, but that one way of overcoming that problem was to ensure that the retainer included that the client's instructions will include the solicitor taking all reasonable steps to enforce any judgment sum obtained against D.

2. It would also seem to follow that, under the 2015 DBA Regulations, contributory negligence, *volenti*, a set-off or counterclaim, or D's insolvency, will all mean no recovery of any DBA fee. The percentage can only apply to the money, or money's worth, i.e., to the '*financial benefit*', obtained. Hence, the intention on the part of the Government seems to be that, if nothing is recovered by way of award or settlement, then no DBA fee will apply.

However, the Working Group raised concerns about a potential lack of clarity regarding the outcome of scenarios where D's counterclaim was either successful or unsuccessful. What exactly was the '*financial benefit obtained*' then, which formed the basis for the calculation of the DBA fee? Explaining the conundrum via a few scenarios:

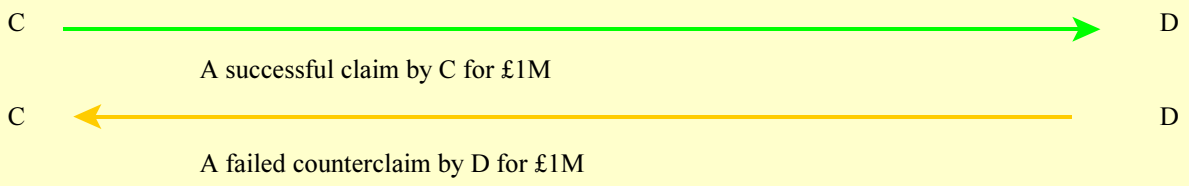
Scenario #1.



In this scenario, C's claim succeeded, and hence, C's solicitor should be entitled to a 50% contingency fee in a commercial matter (assuming that a 50% DBA was entered into), because a DBA can relate to '*only part of the claim or proceedings*', under Reg 3(2)(a). The problem is that C has had a counterclaim succeed against him, for the same amount of £1M, so that C actually recovers nothing over the course of the whole litigation. Hence, in this scenario, should C's solicitor be entitled to recover £500,000 (50% of £1M)? Or £0 (50% of nothing)? Presumably, if C and his solicitor entered into separate DBAs for the claim, and for the counterclaim, then C's solicitor would be entitled to recover £500,000, even though the client ultimately ended up with nothing.

Changing the scenario: what if the counterclaim by D was successfully fought off by C, such that the counterclaim was unsuccessful?

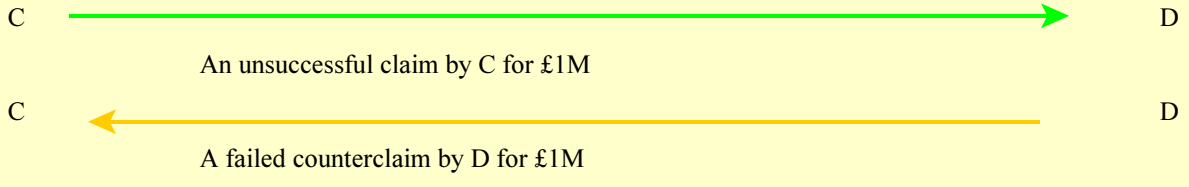
Scenario #2.



Would that mean that C was entitled to £500,000 for the successful claim — and then would **also** be entitled to **another** £500,000, because the defeat of the counterclaim gave C peace of mind, i.e., '*money's worth*', in not having to pay £1M to D? C has arguably received a '*financial benefit*', in not having to pay D under the counterclaim, and C can retain its £1M without having to pay out £1M to D. Even though C actually recovered £1M in this scenario, would C's solicitor **also** be entitled to recover £1M by way of a contingency fee (£500,000 + £500,000)?

Changing the scenario again: what if C's claim failed, but C successfully fought off the counterclaim, so that C's ultimate recovery was £0?

Scenario #3.



This could expose C to having to pay his solicitor £500,000, because the counterclaim was fought off, but where C actually recovered nothing at all. The scenario of the client having to pay the solicitor far more by way of success fee than what the client recovered under the litigation may occur in the CFA context, and this scenario under the DBA — however surprising — is consistent with that.

In the Working Group's view, the concept of '*financial benefit*' is controversial where D wins the litigation, and is being funded on a DBA. To reiterate, '*financial benefit*' is defined in Reg 1(2) to '*include money or money's worth*'. Hence, the DBA fee can attach to anything that is represented by '*money's worth*' — and where D defeats a claim, or C defeats a counterclaim, the concept of '*money's worth*' is not related to the sum that is actually recovered at all, but rather, what '*money's worth*' that party who fought off the claim actually obtained from the litigation.

3. The Working Group was also concerned about a scenario where a judgment which is awarded in favour of C turns out to be unenforceable (e.g., D has no assets within the jurisdiction). Nevertheless, that is a judgment debt in C's favour, and represents an asset (of sorts). Hence, despite the Government's viewpoint noted in para 1 above, could the DBA fee attach to that award, as a '*financial benefit*' which has '*money's worth*'? If so, then a DBA fee could be payable by C.

4. The scenarios mentioned in para 2 above are predicated on the basis that there can be **two** DBAs in existence on C's part — one for C's claim, and another for C's defending of the counterclaim. According to Reg 3(2)(d)(ii)(aa), '*in respect of the claim or proceedings or parts of them to which the agreement relates*', there cannot be '*another agreement between the client and the representative*', regarding the representative's costs, expenses, etc. The Working Group considered that the provision is likely to be directed at prohibiting 'hybrid DBAs' (see Section 8), but wondered whether it was arguable that one DBA for C's claim, and another DBA for C's defending a counterclaim, would offend this provision too. However, presumably, if the claim, and the counterclaim, were different parts of the proceedings, and separate DBAs related to those different parts, then two DBAs would be acceptable.

Recommendations

5.1 The Working Group recommends that the term, '*financial benefit*', and in particular, its sub-definition of '*money's worth*', means that it should be open for a legal representative and his client to define the trigger for payment in the DBA itself where the case is won (i.e., whether securing a judgment, or securing cash, or other '*money's worth*'). Although the concept of '*financial benefit*' is usefully defined in Reg 1(2), the question of what amounts to a 'financial benefit' in the particular case in question should be left to the definition of the parties in the DBA itself on a case-by-case basis — so that the client and the solicitor themselves can agree that the solicitor's fee can be

payable, whether or not the client actually recovers any damages. Given that s 58AA of the CLSA 1990 refers to a '*specified financial benefit*', the client and his solicitor should legitimately be able to specify precisely what constitutes a *'financial benefit*' as a matter of contractual negotiation.

5.2 Although Reg 3(2)(d)(ii)(aa) was supposed to be directed to precluding hybrid DBAs, it is conceivable that it unintentionally covers the use of two DBAs by C — one for a claim and one for a counterclaim. It is recommended elsewhere in this Report (recommendation 15.1) that this provision will need redrafting, if the obligation contained within it is to be rendered a substantive obligation, and not merely something that should be contained in the DBA as a term. Its drafting will need reconsideration for the reason identified in this section of the Report too.

5.3 If the recommendation in 5.1 is not adopted, the Working Group also recommends that the drafting of the 2015 DBA Regulations should make provision for what should happen, where a counter-claim or set-off is brought against C. As illustrated in discussion point 2, if C's DBA fee is to be calculated strictly on what C *actually recovers* in the litigation in terms of money, where a counter-claim applies, then that will yield a different calculation from what the answer would be if one calculated C's DBA fee as a percentage of the '*financial benefit obtained*' by C. Also, the use by defendants of DBAs brings into sharp relief the same dilemma, i.e., that the amount recovered by D (by virtue of a successful counter-claim) may be entirely different from a measure of the '*financial benefit obtained*' (if a defence is successful). Clarification of these issues in the drafting will be necessary, for otherwise, litigation inter partes is very likely, to seek judicial clarification of what is, precisely, the '*financial benefit*' obtained, where counterclaims and defences are won and lost.

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6. THE USE OF DBAs BY DEFENDANTS

The issue

The use by defendants (D) of DBAs has been rendered expressly permissible under the 2015 DBA Regulations. This brings the Regulations into line with s 58AA(3) of the 1990 Act, whereby a '*recipient*' will'*obtain a specified financial benefit in connection with the matter in relation to which the services are provided*', if D is saved from having to pay a judgment or settlement amount by the legal services provided by his solicitor. However, various complexities arise, when DBAs are used by D.

Discussion points

1. Under Reg 7 of the 2013 DBA Regulations, it was contemplated that only *claimants* would enter into DBAs, because of the repeated reference to the contingency fee payment being '*a part of the sum recovered*' (Reg 1), '*the combined sums ... which are ultimately recovered by the client*' (Reg 4(2)(b)), '*an amount ... equal to 50% of the sums ultimately recovered by the client*' (Reg 4(3)), and '*an amount ... equal to 35% of the sums ultimately recovered by the client in the claim or proceedings*'.

However, under the 2015 DBA Regulations, defendant-DBAs are now expressly permitted. For example, under Reg 1(2), '*representative's payment*' means '*that part of any financial benefit obtained in respect of the claim or proceedings that the client agrees to pay the representative*', whilst Reg 4(3) provides that, *'if, in a claim for personal injuries, a financial benefit is obtained by the defendant, a damages-based agreement must not provide for a representative's payment above an amount which, including VAT, is equal to 25% of the financial benefit obtained by the client*'. The Working Group understands that the Government expressly contemplates, under the 2015 DBA Regulations, that it should be permissible for D to use a DBA to fund its defence — in which case, the '*financial benefit*' is the damages that D would have had to pay to C, had C been successful in its claim. Of course, whilst there was no reason, either in principle or under the wording of s 58AA of the CLSA 1990, why D should not be able to make use of a DBA, it would be

necessary for D's solicitor to prove that his client did indeed receive a '*specified financial benefit*' as s 58AA requires.

2. However, the Working Group expressed concerns that, whilst it may be possible to point to the fact that D did indeed receive a '*financial benefit*' from the litigation, in that it successfully defended the suit brought against it, **quantifying** that '*financial benefit*' may, indeed, be very difficult. For example, the amount may, theoretically, be referable to any of the following:

- the reserve which was set aside by D (or by its insurer) to cover the claim;
- the amount stipulated in C's claim form; or
- the Schedule of Loss which is prepared by C, pre-settlement.

The amounts for each of these will probably differ significantly over the course of the litigation. Which is relevant, when assessing the '*financial benefit*' which D obtained from the successful defence?

The issue also arises where D partially succeeds with any defence, such that C recovers some damages, but less than the amount claimed. The amount 'saved' from having to be paid is presumably the '*financial benefit*' obtained by D — but how is that saving to be calculated? Which of the three reference points noted above would apply?

3. The issue is relevant, given the presently-drafted requirement, in Reg 3(2)(b)(ii) of the 2015 DBA Regulations, that the DBA must specify '*a description of the anticipated financial benefit to which the [DBA] relates*'. Hence, the methodology by which that '*financial benefit*' is to be determined would need to be agreed, as between D and his solicitor. D would require clarity about that, before a DBA was entered into. However, the Working Group also queried whether the insertion of a methodology for computing the '*financial benefit*' which D obtained from the litigation (rather than specifying a precise figure) would meet the requirements of a '*specified financial benefit*' in s 58AA(3) of the CLSA 1990. (If, however, the question of what amounts to a "financial benefit" in the particular case in question were to be left to the definition of the parties in the DBA itself on a case-by-case basis, as recommended in 5.1 above, then this concern is moot.)

4. The Working Group did not consider that the 25% cap which applies to C's claim for personal injuries should apply to a successful D in personal injury claims (as is presently provided in Reg 4(3)). The reasons for this view were that: (1) the lower cap was intended to protect **C's** damages obtained in respect of personal injuries, i.e., the most vulnerable of litigants; and (2) C would usually be in individual.

However, the same policy reasons do not apply where D is defending a personal injury claim, given that insurers, large commercially-sophisticated parties, or public bodies, will customarily be defending these suits. In that regard, these types of defendants are in no different a position than any other insured defendant in a commercial matter. In fact, they share remarkable similarities with that type of D, in that they are sophisticated purchasers of legal services and have significant purchasing power. In that light, there is a strong argument that the 50% cap which applies to commercial matters should apply to the defence of personal injury claims. In other words, there were sound reasons for treating C and D lawyers differently in personal injury cases, as the 25% cap for C's solicitor was directed primarily to protecting that particular type of vulnerable client.

5. Given the drafting of Reg 4(3), the Working Group assumed that the heads of damage upon which D's solicitor's DBA fee may be calculated will **not** be restricted to the particular heads of damage that apply for C's claim for personal injury (per Reg 4(2)(a)), but rather, will apply to the **entirety** of the damages 'saved' from being paid.

Recommendations

6.1 The Working Group recommends that the present drafting of Reg 3(2)(b)(ii) be reconsidered, to ensure that it could be met by the setting out of a methodology by which D's '*financial benefit*' is to be calculated (given that such a methodology may be the only feasible way of describing the anticipated financial benefit, at the outset of the litigation). This is especially so, when there are at least three different reference points for assessing what amount of damages was actually saved by D's successful (either entire or partial) defence of the litigation.

6.2 Further, the Working Group recommended that Reg 4(3) be amended, to substitute a 50% cap for the presently-stated 25% cap. (Alternatively, the Working Group recommended that Reg 4(3) could be deleted, in which case a DBA used by D to defend personal injury claims would be encompassed

within the catch-all provision of Reg 4(4), which itself provides for a DBA cap of 50%.) If Reg 4(3) is retained, then clarifying that the damages to which the DBA fee applied did not pertain only to the heads of damage that are stipulated in Reg 4(2)(a) may also be helpful.

6.3 On balance (this point was subject to differing views amongst members), the Working Group recommended that Reg 4(3) re retained explicitly (but redrafted according to the recommendation in 6.2), rather than permitting a DBA used by D to defend personal injury claims to merely be encompassed within the catch-all provision of Reg 4(4), which itself provides for a DBA cap of 50%. Retaining Reg 4(3) would emphasise that the cap of 50% for a defendant's DBA, in respect of a claim for personal injuries, was intentional and not inadvertent.

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7. THE RETROSPECTIVE AND PROSPECTIVE EFFECT OF THE 2015 DBA REGULATIONS

The issue

Funding arrangements by some parties have been put in place already, under the 2013 DBA Regulations (which took effect on 1 April 2013). These will continue to have full effect (assuming that they are lawful and enforceable under the 2013 Regulations), regardless of what the 2015 DBA Regulations may provide.

Discussion points

1. The 2013 DBA Regulations have governed DBAs since these Regulations took effect on 1 April 2013. They have also provided the framework upon which Third Party Funders have obtained advice so as to ensure that their arrangements are not inadvertently caught by those Regulations. When the 2015 DBA Regulations take effect for personal injury or commercial matters, the 2013 DBA Regulations '*shall continue to have effect in respect of any damages-based agreement to which those regulations applied and which was entered into before the date on which these [Redrafted] Regulations come into force*' (per Reg 2(2)). The Working Group did not consider that there would be any transitional problems, and that it would be clear as to the date upon which a DBA was '*entered into*'.

2. Further, the 2015 DBA Regulations will have prospective effect only, in that they '*apply to all damages-based agreements entered into on or after the date on which these Regulations come into force*' (per Reg 1(3)). Again, the Working Group did not envisage any difficulty arising from this provision.

Recommendation

7.1 No amendments to Regs 1(3) or 2(2) were necessary. Both provisions are clear and workable.

8. THE DEFINITION OF A 'HYBRID DBA'

The issue

Under one form of 'hybrid DBA', a law firm receives *concurrent* funding via both a DBA and via some other form of retainer (e.g., discounted hourly rates), in the event of the claim's success; and receives the discounted hourly rate fees in the event of the claim's failure. This 'concurrent hybrid DBA' represents a scenario that the Government has indicated that it wishes to avoid. On the other hand, *sequential* forms of funding, where a DBA comprises one or other of those methods of funding for different stages of the legal proceedings, do not offend the Government's policy on co-funding. This is called a 'sequential hybrid DBA' in this section, for the sake of clarity.

The distinction between the two types of hybrid DBAs arises directly from terms of reference (please refer to page iv), and in particular, from the query as to whether the 2015 DBA Regulations could benefit from '*clarifying that different forms of funding cannot take place at the same time, although they could do so at different stages of a case*'. This term of reference raises various points of interest and uncertainty, to do with the drafting of a lawful and enforceable 'sequential hybrid DBA'.

It must be emphasised that this section focuses upon the types of arrangements in which a DBA, plus some other form of retainer, **may** be feasible, at least as the drafting of the 2015 DBA Regulations stands, in order to facilitate the sequential hybrid DBA. Whether concurrent hybrid DBAs should be permitted (contrary to the Government's current stance) is a policy matter, and is dealt with in Section 21 of the Report.

Discussion points

1. The DBA must state 'the claim or proceedings, *or parts of them*, to which the agreement relates', per Reg 3(2)(a). By virtue of this provision, a DBA could feasibly relate to *one stage only* of the proceedings — whilst presumably an hourly rate retainer could apply to other stages or parts of the proceedings. Hence, a permissible type of 'hybrid DBA' is where the claim is successful, and the solicitor is paid for its 'base

costs' (or the WIP incurred in conducting the case) up to a particular stage of the proceedings; and thereafter, the solicitor can be paid a percentage of damages recovered. It is a consecutive or sequential form of funding, which does not raise the same policy concerns as do concurrent forms of funding. The Working Group understands that the Government considers that it is not unreasonable for a solicitor to use one form of funding for one stage of the proceedings (i.e., to investigate the merits of the case, or to obtain expert reports), and then proceeding to another form of funding (i.e., a DBA, as the only form of funding) for the next stages of the claim.

2. The Working Group considered various permutations of how a 'sequential hybrid DBA' could work.

For example, it would presumably be permissible, for example, for a solicitor to act on an hourly rate retainer for the entirety of the conduct of the litigation up to 'the point at which any settlement offer is rejected', or 'up to, but excluding trial', or 'up to the completion of disclosure' — and then convert to a DBA for the trial itself (or for a later settlement offer, should that occur). In other words, the solicitor would be permitted to charge an hourly rate for the investigative and preparatory stages, and then to convert to a DBA for the settlement or trial stages. Under this arrangement, the solicitor would be entitled to be paid an hourly rate for the investigations of the merits of the case, the obtaining of experts' reports, disclosure, and so on. Then, conversion to a DBA — say, 'for trial', or 'post-disclosure', or 'post the delivery of expert's reports' — would enable the solicitor to claim a share of the damages awarded or agreed by way of settlement.

Of course, the very point at which the hourly rate retainer agreement ended, and the DBA agreement commenced, would need very careful drafting, to ensure that there was no overlap that could infringe the 'concurrent hybrid methods of funding' which the Government is so keen to disallow. Absolutely no hourly rate could be payable in relation to the part of the claim or proceedings to which the DBA related.

Alternatively, the DBA could be drafted so as to relate to all parts of the claim or proceedings, 'except for [itemised legal tasks]'. That is, a DBA could be drafted to cover the whole of the case, except that hourly rate retainers could apply to, say, the preparation of witness statements, or the undertaking of disclosure. This would avoid having to draft the DBA to commence at a particular moment in time. However, by corollary, a DBA of this sort may not be *sequential* at all, because the preparation of witness statements on the hourly rate retainer may be concurrent with other legal work which was the subject of the

DBA. Nevertheless, as the wording of Reg 3(2)(a) is presently drafted, this scenario does seem to be permissible.

Given the various permutations described above, the Working Group considered that a definition of the word, 'part', would be apposite. Some members noted that the word had been used in the context of the Conditional Fee Agreements Regulations 1995 (Reg 3), without problems occurring. However, the Working Group considered that, given that some forms of hybrid DBA were to be permitted, and some forms were not, then the utmost clarity, in the 2015 DBA Regulations, as to what types of hybrid were permitted was essential. After all, the consequence of misunderstanding what a 'part' could mean could be a complete lack of recovery of any fees at all, if the DBA itself was rendered unenforceable.

3. One of the attractions of this sequential hybrid DBA arrangement to the solicitor is that the solicitor would be entitled to be paid the retainer fee, whether C won or lost the case. That part of the funding would not be contingent upon success. Even if the experts' reports, or disclosure, reflect that C's case is very poor and not worth proceeding with, at least the solicitor would be paid for the legal work expended in getting to that (disappointing) point. The DBA fee itself cannot be paid unless C 'obtains a financial benefit' — but there is no such restriction on the retainer 'bit' of the funding, as the 2015 DBA Regulations are presently drafted. Hence, a sequential hybrid DBA could mix contingent versus non-contingent funding, and could tailor funding methods for when they would be most beneficial (e.g., an hourly rate in the early or mid-stages of the litigation).

However, regardless of the type of claim at issue, the Working Group noted that if these sorts of sequential hybrid DBAs were permissible, then their effect would need to be very carefully explained to the client, at the time of entering into the various fee agreements, in the interests of client protection.

4. Inevitably, however, under a 'sequential hybrid DBA' arrangement, the question arises as to whether the solicitor could 'bank' the fees earned via the retainer, and add the DBA fee to it — or whether the solicitor would have to offset the fees earnt via retainer against the DBA fee.

If the former, then naturally, that would present a more attractive option for the solicitor. Theoretically at least, separate payments should be justifiable, on the basis that one form is contingent on

success (the DBA), and the other (the hourly rate retainer) is not contingent, and hence, is payable regardless of whether C wins or loses.

On the other hand, if an offsetting exercise were required, then the solicitor would never be permitted to bank any fees earnt from the retainer, until it was known whether the client received any '*financial benefit*' from the litigation (and whether there was any DBA fee to offset). In this scenario, sequential hybrid DBAs would presumably not be particularly attractive to the solicitor, for the solicitor would be 'carrying the case' for the duration of the claim, without any sort of WIP funding coming in.

Recommendations

8.1 Although the prospect of sequential hybrid DBAs is allowed by the drafting of Reg 3(2)(a) of the 2015 DBA Regulations, the Working Group considered that the Regulations should define what a 'part' of the claim or proceedings could entail (e.g., whether the 'part' can be a reference to a time period, or a legal task, or an issue, or a claim or counterclaim).

8.2 The Working Group also recommends that the 2015 DBA Regulations need to specify clearly whether the solicitor can retain the monies recoverable under the non-DBA funding agreement, and to which the DBA fee should be added (if recoverable); or whether it is intended that the monies recoverable under the non-DBA funding agreement should be offset (i.e., included within) the DBA fee, once paid. The answer to this conundrum is not provided on the face of the 2015 DBA Regulations as presently drafted, but will have great ramifications upon the utility of sequential Hybrid DBA agreements.

8.3 Finally, as a corollary of recommendation 8.2 above, the Working Group considers that the 2015 DBA Regulations should clarify (to whatever extent that may not be clear already, from the drafting associated with 8.2 above) that, in respect of that part of the claim or proceedings to which the DBA does not relate, the payment of the solicitor's costs and expenses, are payable, regardless of whether or not the client receives any of the '*financial benefit*' stated in the DBA (i.e., that the converse of what is presently in Reg 3(2)(d)(ii)(bb) should be spelt out).

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9. THE FUNDER'S 'HYBRID DBA' MODEL

The issue

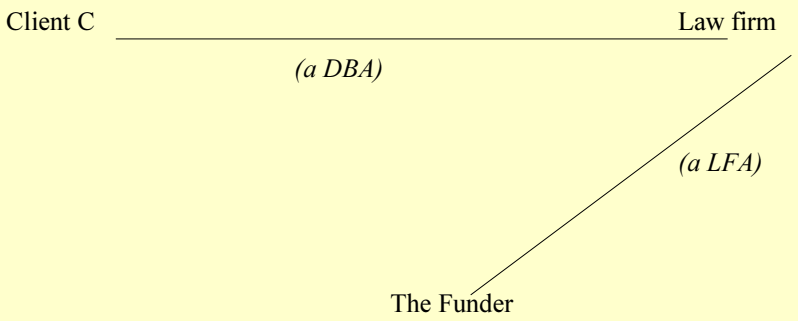
Various Third Party Funders (e.g., Harbour Litigation Funding; Burford Capital) have developed 'Hybrid DBA' models to facilitate the funding of commercial litigation claims with sophisticated clients, and with full disclosure to the client of the funding arrangements, and with legal advice endorsing the funding arrangement. The query is whether these hybrid DBAs could be inadvertently 'caught up' under the 2015 DBA Regulations.

Discussion points

1. The Working Group particularly considered the effect of Reg 3(2)(d)(ii)(aa) of the 2015 DBA Regulations, which provides as follows: '*The terms and conditions of the DBA must specify that, in respect of the claim or proceedings or parts of them to which the agreement relates — the payment of the representative's costs, expenses and, where relevant, disbursements in respect of counsel's fees will not be the subject of another agreement between the client and the representative.*' The concern was whether a Funder's hybrid DBA would be inadvertently covered by this provision (it seemed the most relevant of all of the provisions of the 2015 DBA Regulations). It would appear that some quite complex funding arrangements have already been put in place for commercial litigation, and which would not involve the scenario that the Government is keen to avoid — but the drafting of the new Regulations needed to be scrutinised for that purpose.

2. Both Harbour Litigation Funding and Burford Capital attended at a meeting of the Working Group, to explain how their Hybrid DBAs worked. The arrangements for the Funders' hybrid DBAs may be diagrammatically shown as follows:

The Funders' Hybrid DBAs:



Under this arrangement:

- the DBA between client C and law firm entails that, if C succeeds in the case, then the law firm takes the percentage of the recovery (say, 50%), under a DBA. That DBA will be capped according to the statutory caps set by the 2013 DBA Regulations. That money, paid under the DBA to the law firm, is held on trust, for payment to the Funder under the Litigation Funding Agreement;

- then, as between the law firm and the Funder, there is the usual Litigation Funding Agreement, under which the Funder provides non-recourse funding for WIP (usually, funding paid at a reduced hourly rate, to keep the law firm's activities funded during the course of the litigation), plus the Funder will typically pay the disbursements incurred by C in preparing for his case (e.g., experts, counsel, ATE premium). Then, if C succeeds in the case, the Funder is entitled to a success fee under that LFA, which is payable by the law firm. The law firm may also contract to pay back the money advanced by the Funder, if C wins the case. That money to the Funder is paid out of the trust funds which the law firm obtained under the DBA, such that the Funder's success fee is paid out of the DBA cap. The Funder cannot recover more than the DBA cap, such that the Funder essentially 'obtains a proportion of a proportion'.

- however, as between client C and the Funder, importantly, there is **no** funding contract. Notably, even if the Funder provides ATE insurance to client C, that insurance policy will **not** be entered into by the Funder, *in its capacity as a Funder*. The Funder will act as the ATE insurer's underwriting

agent/administrator, and will contract with client C on behalf of that ATE insurer. Hence, there is no ATE insurance contract between the Funder and the client. That contract is purely between client C and the ATE insurer (for whom the Funder is agent).

Hence, it is apparent that this arrangement does not infringe Reg 3(2)(d)(ii)(aa), as there is no other agreement between the client C and the law firm for payment of the solicitor's fees. The only other arrangement on foot is between the law firm and the Funder — so that, if the law firm wants a second agreement by which to be paid WIP, and the disbursements involved in pursuing the case, whilst the case is being conducted, then that will need to be entered into a Funder (or with some other party — but it won't be an agreement with the client). And even if an ATE contract has been taken out, that is not entered into between client C and the solicitor either, so does not infringe the wording of this Regulation.

3. There was also a suggestion that the LFA may be scheduled to the DBA, for information purposes. However, the Working Group considered that scheduling of this type does not render client C a party to that LFA, and hence, it could not be said that client C is paying the law firm via a second agreement — the law firm is being paid *by the Funder*, and C is not a party to that agreement.

Recommendations

9.1 As currently drafted, the 2015 DBA Regulations, in particular, Reg 3(2)(d)(ii)(aa), are not infringed by the Funders' Hybrid DBAs to which the Working Group had regard. (The Working Group cannot comment upon other Hybrid DBAs which may be offered by other Funders on the market.)

9.2 If a law firm enters into a DBA with client C, and wishes to be paid for its WIP during the course of the conduct of the litigation, there is nothing on the face of these Regulations to prevent that law firm from entering into a second agreement for payment of that WIP — provided that the second agreement is entered into with a Funder, or some other party, *but not with the client C*.

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10. EXCLUDING THIRD PARTY FUNDERS' LITIGATION FUNDING AGREEMENTS (LFAs) FROM THE AMBIT OF THE DBA REGULATIONS

The issue

It was argued in some quarters that LFAs were inadvertently caught up by the 2013 DBA Regulations (although, as a matter of statutory drafting and interpretation, it is very strongly arguable that the Regulations do **not** cover LFAs). However, for the removal of any slight prospect of satellite litigation on this point, however vainly pursued, the Ministry of Justice has conveyed the view to the Working Group that LFAs should be expressly omitted from the scope of the 2015 DBA Regulations.

Discussion points

1. The Working Group agreed that, as per the arguments canvassed in Mulheron, *The Evolution of Third Party Funding: An Analysis of Current Statutory and Legal Issues* (Jan 2014), pp 42–43, and 'England's Unique Approach to the Self-Regulation of Third Party Funding: A Critical Analysis of Recent Developments' (2014) 73 *Cambridge LJ* 1, 26–27, it was extremely unlikely that Third Party Funders were inadvertently covered by the 2013 DBA Regulations. However, the intent of the Ministry of Justice to set any remote residual uncertainty about the point at nought was noted.

2. The first drafting suggestion by which to achieve that outcome was to amend Reg 1(2) of the 2015 DBA Regulations as follows (in bold):

> *"representative" means the person providing the advocacy services or litigation services to which the damages-based agreement relates,* ***but excludes "a Funder" as defined in clause 2 of the Code of Conduct for Litigation Funders 2014****;*

This would ensure that the 2015 DBA Regulations excluded the *entity* (i.e., the Funder). This appears to be a better option than seeking to exclude what Funders do.

The reason for that view is that the Working Group was concerned that, under the definition of 'representative' above, a Funder could be taken to be providing '*litigation services*' — as that term is defined (very widely) in s 119 of the CLSA 1990, to mean, '*any services which it would be reasonable to expect a person who is exercising, or contemplating exercising, a right to conduct litigation in relation to any proceedings, or contemplated proceedings, to provide*'. The Working Group understands that Funders may, from time to time, undertake services that a solicitor would otherwise (or additionally) provide to a client, e.g., due diligence checks, verifying the defendant's capacity to meet any judgment that may be obtained against it, undertaking a preliminary merits assessment of the case, etc. Hence, excluding a Funder, as an entity, would avoid any attempt to exclude the activities or services which a Funder undertakes.

However, the Working Group queried whether, as a drafting protocol, a Code could be incorporated as a source of definition in the 2015 DBA Regulations. In that regard, the Working Group notes, for example, that the *Pre-Action Protocol for Personal Injury Claims* refers (in para 4.2) to the Rehabilitation Code, and hence, there may be some precedent for that approach.

This option would also require that the definition of a 'funder' in clause 2 of the Code of Conduct for Litigation Funders should be kept under review by the Association of Litigation Funders, which has the responsibility for the oversight of that Code.

3. An alternative drafting suggestion by which to exclude Funders from the 2015 DBA Regulations would be to amend Reg 1(4) as follows (in bold):

> *These Regulations do not apply to—*
> *(a) any damages-based agreement to which section 57 of the Solicitors Act 1974 (non-contentious business agreements between solicitor and client) applies;*
> *(b) an employment matter;* ***or***
> ***(c) a "litigation funding agreement" as defined in s 58B(2) of the Courts and Legal Services Act 1990.***

The Working Group queried whether it was acceptable, as drafting protocol, to cross-refer to a statutory definition in a provision which has yet to come into force, given that s 58B of the CLSA 1990 remains prospective only. The Ministry of Justice expressed some reservations about referring to uncommenced legislation. The simpler option would be to repeat the relevant definition from s 58B(2) in the 2015 DBA Regulations.

4. The Working Group also noted that it was foreseeable that some Funders might also offer 'claims management services' in due course (defined, in s 4(2) of the Compensation Act 2006), to mean '*advice or other services in relation to the making of a claim*'), particularly because some may become involved in 'book-building' of shareholders' claims. If so, then these Funders will be duly covered by the Compensation (Claims Management Services) Regulations 2006. In such circumstances, it provides further impetus for excluding Funders from the ambit of the 2015 DBA Regulations.

Recommendation

10.1 The Working Group recommended that Reg 1(4) of the 2015 DBA Regulations should be amended as follows (with the amendment shown in bold):

These Regulations do not apply to—

(a) any damages-based agreement to which section 57 of the Solicitors Act 1974 (non-contentious business agreements between solicitor and client) applies;

(b) an employment matter; ***or***

(c) an agreement ("a litigation funding agreement") under which—

(i) a person or entity ("the funder") agrees to fund (in whole or in part) the provision of advocacy or litigation services (by someone other than the funder) to another person or entity ("the litigant"); and

(ii) the litigant agrees to pay a sum to the funder in specified circumstances.

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11. SLIDING SCALE PAYMENTS

The issue

The percentage fee to which the legal representative is entitled under a DBA may vary, depending upon the stage at which the claim or proceedings are finalised; or may depend upon the amount of recovery achieved by C. Both are 'sliding scale' payments, and are permitted, provided that the total does not exceed the DBA caps (25% for personal injury and 50% for commercial cases). The issue is whether, and if so, how these arrangements need to be specified in the 2015 DBA Regulations.

Discussion points

1. The Working Group considered that there were **two** types of sliding scale payments possible under a DBA.

The first type was an adjustment of the DBA fee, depending upon when the case concludes. That type is provided in the 2015 DBA Regulations, in Reg 3(2)(b)(i), i.e., '*The terms and conditions of the damages-based agreement must specify — (b) the circumstances in which the representative's payment, expenses and costs, or part of them, are payable, including — (i) where relevant, whether the amount of the representative's payment depends upon the stage at which the claim or proceedings are concluded.*' This would cover circumstances where the DBA fee was, say: 30% of the 'financial benefit obtained by C' if the case settles; 40% of the 'financial benefit obtained by C' if the case settles less than 45 days prior to trial; and 50% of the 'financial benefit obtained by C' if the case proceeds to trial. (This type of sliding scale is typical of an ATE premium.) As long as the totality of payments is less than the DBA cap, then this arrangement is lawful under the 2015 DBA Regulations. The point was also made that sliding scale payments of this type were attractive for clients and legal representatives alike, as they tied the recoverable amount of damages to the work that was needed to be done, to secure a recovery for the client.

2. The second type of sliding scale DBA fee which is possible is where the percentage depends upon the level of recovery obtained by C. This would cover circumstances where the DBA fee was, say, 5% of the first £5M recovered; 10% of the next £1M; and 40% of anything in excess of that. (This type of sliding scale is typical of many Funders' litigation funding agreements.) On one possible reading, this type of sliding scale DBA fee is provided for in the 2015 DBA Regulations, in Reg 3(2)(c), i.e., '*The terms and conditions of the damages-based agreement must specify — (b) the reason for setting the amount of the representative's payment at the level or levels agreed'*. Alternatively, if that type of sliding scale DBA fee is not covered by Reg 3(2)(c), then presumably the '*description of the anticipated financial benefit to which the agreement relates*' would need to specify that type of sliding scale payment. Presumably, again, provided that the totality of payments is less than the DBA cap, this sliding scale arrangement would be lawful under the 2015 DBA Regulations.

3. The Working Group were divided, as to whether Reg 3(2)(b)(i) was required, or whether Reg 3(2)(b) should stop at 'payable'; and whether Reg 3(2)(c) was required either.

On one view, they were not required, as they served no purpose — if the DBA fee does depend upon the stage at which the case concludes, or the level of financial benefit obtained, then the DBA will **have** to specify that, because the legal representative's contractual entitlement depends upon that being set out in the DBA. By contrast, if no sliding scale is contemplated between the parties, then there is no need to mention it in the DBA, as it is not 'relevant' or necessary. According to this view, any legislative requirement to include these sliding scale payments means that any technical failure to comply could render the DBA unenforceable, and could preclude any recovery by the legal representative at all (with no *quantum meruit* available). The client care letter was a preferable place to put that information for the client's benefit. The 2015 DBA Regulations did not have to state that. If these clauses were retained in the Regulations, then either client or opposing party would seek to scrutinise the DBA, to determine whether there was any technical infringement of either clause, in which case there would be no recovery at all by the legal representative.

On the other view, Reg 3(2)(b)(i) and Reg 3(2)(c) should be left in, as they were both for the client's benefit. Both were directed to the purpose of informing the client as to when (and what) that party had to pay to the legal representative. This was important enough to warrant inclusion in the 2015 DBA Regulations, as a term and condition of the DBA, failing which the DBA will be unenforceable. However, the drafting

of the 2015 DBA Regulations could be worded so as to avoid a need to specify the stages at which the fee was payable, unless the payment was indeed staged.

4. Finally, the Working Group did not consider that the words, 'and costs', should be retained in Reg 3(2)(b), opening words. Under the DBA, it is the legal representative's DBA fee (i.e, payment) and expenses (i.e., disbursements) which are payable. The addition of 'and costs', serves to confuse, and the purpose of their inclusion is not clear.

Recommendations

11.1 The Working Group was divided in opinion, as to whether the provisions for a sliding scale of DBA fees (whether determined on the stage at which the proceedings are concluded, or on the basis of the level of financial benefit obtained by C) — *viz*, Reg 3(2)(b)(i) and Reg 3(2)(c) — should be retained in the 2015 DBA Regulations, as being requisite terms of the DBA. Essentially, this division of opinion reflected the reality that, the more mandated content for the DBA which the Regulations specified, the more likely that a legal representative would omit to include some technical matter, thereby rendering the DBA unenforceable (a disastrous consequence, with no *quantum meruit* available to that legal representative). According to the opposing view, however, that mandated content for the DBA was a price worth paying, to promote full disclosure to the client of the sliding scale payments for which he will be liable.

11.2 In Reg 3(2)(b), opening words, the phrase, 'and costs' should be deleted, as those are not payable under the DBA itself.

11.3 The Working Group also recommends that the 2015 DBA Regulations should clarify (preferably by a suitable amendment of Reg 3(2)(c)), that the second type of sliding scale DBA fee identified by the Working Group, i.e., where the percentage of recovery depends upon the level of damages recovery obtained by C, is permitted.

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12. THE APPLICATION OF THE DBA REGULATIONS, PRE-COMMENCEMENT (INCLUDING THE APPLICATION OF THE REGULATIONS TO CMCs)

The issue

The definition of a DBA, in s 58AA of the CLSA 1990, was amended by s 58AA(7A), so that '*proceedings*' in relation to DBAs '*includes any sort of proceedings for resolving disputes (and not just proceedings in court) whether commenced or contemplated*'. Hence, the overarching Act seemed to cover DBAs, even if entered into before proceedings commenced. However, under the 2015 DBA Regulations, Reg 1(4) provides that *'these Regulations shall not apply to any damages-based agreement to which s 57 of the Solicitors Act 1974 (non-contentious business agreements between solicitor and client) applies.*' The query arises as to whether the 2015 DBA Regulations apply to DBAs governing disputes which are settled before suit is filed.

Discussion points

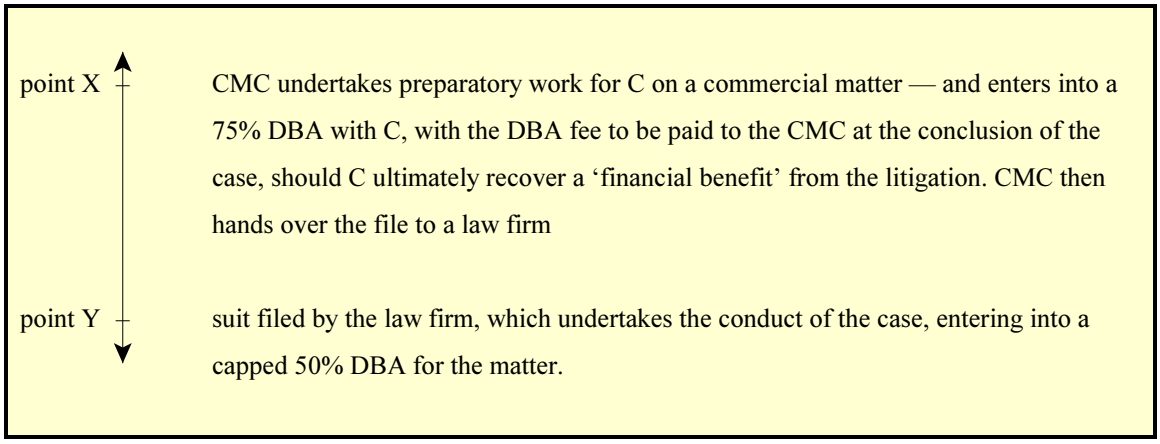
1. One concern arising from Reg 1(4) of the 2015 DBA Regulations is that they do not apply to DBAs for non-contentious business — which would mean that C, who had entered into a DBA for proceedings which settled prior to any suit being commenced, would **not** be subject to the protection of the Regulations. In particular, that DBA could be uncapped. Whilst the amended DBA definition in s 58AA(7A) seems to permit that contemplated proceedings are the proper subject of a DBA, the 2015 DBA Regulations excises pre-suit DBAs from their remit, and leaves those unregulated.

However, the Working Group notes the Ministry of Justice's view that the CLSA 1990, which permits the use of DBAs in civil litigation, does not extend to pre-issue proceedings — and that the 2015 DBA Regulations **cannot** apply to DBAs entered into for operation prior to the issue of a claim, unless that primary legislation is amended. To note, the Working Group does not fully understand the basis for that view, on the face of the wording used in s 58AA of the CLSA 1990, given the very wide definitions of '*advocacy services*' and '*litigation services*' used in s 119 of the CLSA 1990 which are included within s 58AA, and which definitions do appear to cover pre-issue proceedings. Furthermore, s 58AA(7A), it is

explicitly provided that '*proceedings*' '*includes any sort of proceedings for resolving disputes ... whether commenced or contemplated*' — which seems to incorporate pre-claim proceedings as being properly within the province of s 58AA of the CLSA 1990.

Nevertheless, the Working Group wished to register its concern about the prospect of pre-suit DBAs being entirely unregulated and uncapped.

2. A further concern of the Working Group was that, pre-suit, claims management companies (CMCs) may assist with the preparation, collection, and aggregation of claims, undertaking non-contentious business in relation to those claims. Hypothetically, as the 2015 DBA Regulations currently stand, there would be nothing to stop the following arrangement from taking place:



Under Reg 3(2)(a), the DBA must state '*the claim or proceedings or parts of them to which the agreement relates*'. Hence, a DBA could be viably entered into between C and CMC pre-suit — and another DBA, in respect of the same matter, could be then entered into between C and a law firm. As discussed previously under issue 8, sequential hybrid DBAs are lawful and permissible under the 2015 DBA Regulations. Moreover, these DBAs could be entered into between C, and different entities, along the journey of a claim.

Additionally, the emergence of Alternative Business Structures means that, where a CMC was part of an ABS, then that CMC could do preparatory work for a case, and it may be attractive for that CMC to enter into a pre-suit DBA with C (for an uncapped DBA fee), and then to hand over the case to a law firm

(also part of that ABS) who could enter into another DBA with that same C for the conduct of the litigation, post-filing (but which would be under a capped DBA).

All of this means that an entirely unregulated DBA landscape, pre-filing, raises serious issues of consumer protection (or lack thereof), if capping, and all the other regulatory protections contained in Regs 3 and 4, do not apply to pre-commencement DBAs.

3. The Working Group also notes the comments of the Conservative Government in its Budget Speech (8 July 2015, section 3.9), in which the Government foreshadowed a '*fundamental review of the regulation of claims management companies ... the Government will bring forward proposals for the introduction of a cap on the charges that CMCs can apply to their customers, and will consult on how this will work in practice*'. The Working Group notes that this review may well impact upon the pre-filing landscape, where CMCs may lawfully operate, and that any findings of that review (to be led by the Chairman of the Chartered Trading Standard Institute Board) will ultimately be relevant to this DBA issue.

4. The Working Group further discussed the interplay between solicitors and CMCs; the definitions of 'non-contentious business' under s 57 of the Solicitors Act 1974; what is covered by taking steps which could be construed as providing 'advocacy services' or 'litigation services'; the meaning of 'reserved legal activities'; and where the boundary lines between a CMC's sphere of activity and a solicitor's activity was to be drawn, under the presently-existing regulatory framework. These issues appear to the Working Group to be complex and challenging, and worthy of further investigation and round-table discussions, but which work exceeds the bounds of this current Working Group's remit. However, in a nutshell, there may potentially be instances where a solicitor's DBA was caught by the 2015 DBA Regulations (and thus, required to be capped), whereas a CMC which is doing pre-filing work could operate under an uncapped DBA.

The Working Group wishes to emphasise that it is not advocating the protection of solicitors in pointing out this disparity, but is merely indicating that, from the perspective of consumers who are seeking legal and other services in an increasingly-complex market, the disparity may cause confusion and consumer detriment. The area would appear to warrant some further consideration, in due course.

5. As an aside the Working Group also noted that there was a prospect that — even for DBAs that are entered into post-commencement of the litigation proceedings — CMCs could be caught up by the definition of '*representative*' in Reg 1(2) of the 2015 DBA Regulations. That is defined as '*the person providing the advocacy services or litigation services to which the damages-based agreement relates*'.

Notably, the 2013 DBA Regulations had specifically included those who provide '*claims management services*' in the definition of a '*representative*', in Reg 1(2). However, the definition of a '*representative*' has been changed in the 2015 DBA Regulations, in that it now excludes any reference to '*claims management services*'. Whilst s 58AA(3) of the CLSA 1990 specifically refers to '*claims management services*' as being the proper province of DBAs (please see Appendix 2), the Working Group understands that the Ministry of Justice considers that CMCs will be covered by the to-be-introduced DBA Regulations for employment matters, where CMCs are actively-engaged. (Notably, CMCs are also covered by their own regulatory code, Claims Management Regulation: Conduct of Authorised Persons Rules 2014 (available at: https://www.gov.uk/government/publications/claims-management-regulation-conduct-of-authorised-person-rules-2014).

However, given the width of the definition of '*litigation services*' in s 119 of the CLSA 1990, the Working Group considered that, nevertheless, CMCs may feasibly offer such services — because that definition encompasses '*any services which it would be reasonable to expect a person who is ... contemplating exercising a right to conduct litigation in relation to any ... contemplated proceedings, to provide.*' This is a broad definition that could cover a range of activities — even before a claim was commenced. Some of the preparatory work carried out by a CMC is surely assistance that would be '*reasonable to expect*' in relation to '*contemplated proceedings*'. In other words, a CMC's provision of assistance to C, pre-suit, is being done in contemplation of litigation, and under that interpretation, the 2015 DBA Regulations could technically apply to a CMC — notwithstanding that CMCs are required to only transact non-contentious business and are not entitled to provide advocacy or litigation services.

The Working Group was concerned that the removal of '*claims management services*' from the ambit of the definition of '*representative*' in Reg 1(2) of the 2015 DBA Regulations might have been based upon a misunderstanding that CMCs are **only** involved in employment work, but that is not the case. It was conceivable that CMCs could be a '*representative*' — which would mean that CMCs **were** caught up and

regulated by the 2015 DBA Regulations. Whilst that may be desirable for some reasons, it would presumably be an entirely unintended consequence of the 2015 DBA Regulations. Again, the interplay between the 2015 DBA Regulations and CMCs and ABSs would seem to warrant further consideration, possibly by a specialist Working Group of interested parties and stakeholders.

Recommendations

12.1 Given the concern about the lack of consumer protection which may arise, if DBAs entered into pre-suit (whether by a solicitor or by any other entity), in respect of 'non-contentious business', are not regulated, the Working Group recommends that the Government may wish to reconsider the necessary amendments to primary legislation to permit DBAs to be regulated, pre-commencement of litigation. However, the full implications of this recommendation for all types of business would need to be considered carefully.

12.2 The interplay, as between legal representatives who use the one DBA for pre- and post-issue stages of a proceedings (which would be covered by the 2015 DBA Regulations) and CMCs which provide pre-litigation services (which would not be covered by those Regulations), should also be given further consideration, when considering the application of DBAs pre-suit.

12.3 The arguable proposition that CMCs may be drawn into the ambit of the 2015 DBA Regulations, by virtue of the wide definitions of the '*advocacy services*' and '*litigation services*' which appear in the definition of the '*representative*' in Reg 1(2) — notwithstanding that any reference to '*claims management services*' was removed from that definition in the 2015 DBA Regulations — gives rise to the prospect of satellite litigation on this issue (particularly if C objects to the fee agreement entered into with the CMC). The Working Group recommends that the situation regarding the application of the 2015 DBA Regulations to CMCs, be further investigated and then clarified, either within the Regulations or in relevant primary legislation.

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13. THE POSITION RE APPEALS

The issue

Uncertainty arises as to whether the 25% (for personal injury) and 50% (for commercial matters) DBA caps can be exceeded, where an appeal is pursued. Regulation 4(5) of the 2015 DBA Regulations provides that the caps prescribed under the Regulations '*shall only apply to claims or proceedings at first instance*.'

Discussion points

1. The Working Group envisaged that, much as occurs with CFAs, the DBA should specify whether it covers an appeal, a counter-claim, or first instance proceedings only. It is plain that C and his legal representative can enter into separate DBAs for the first instance proceedings and for any appeal arising therefrom, given that Reg 3(2)(a) of the 2015 DBA Regulations requires that any DBA '*specify the claim or proceedings or parts of them to which the agreement relates.*' However, the Working Group considered that, in practice, many parties would not distinguish a claim from any appeal, and that the DBA entered into at the outset would purport to cover 'the whole claim'. Whether the 2015 DBA Regulations should insist that the DBA for the first instance proceedings specified whether or not that DBA covered 'the whole claim', or whether the DBA could validly remain silent on that issue, was a topic upon which the Working Group was divided (see Recommendation 13.2 below).

2. Suppose that separate DBAs were entered into, for first instance proceedings and for an appeal. The Working Group was concerned about how the DBA fee would be calculated, in those scenarios in which the amount awarded to C changed from first instance to appeal. That could occur for a range of reasons — if, say, a defence was upheld or discounted on appeal, or further/fewer heads of damage were awarded on appeal, or if another cause of action arising from the same set of facts succeeded or failed on appeal. Are the DBA caps (25% for personal injury and 50% for commercial) disapplied on appeal, and if so, how would that work in practice? Of course, the appeal amount may be higher or lower than that which was awarded

at first instance — and precisely what C's legal representative would be entitled to recover then, by way of a DBA fee, is unclear.

For example, the Working Group considered some hypothetical scenarios, to illustrate the uncertainties arising:

Scenario #1. C is awarded £5M in a commercial matter at first instance, and has entered into a 50% DBA with his legal representative. D appeals, and C then enters into a 90% DBA with his representative for the conduct of the appeal, because no DBA cap applies to that appeal, and the risk assessment of C's losing on appeal is high and the work required by the legal representative is considerable. On appeal, C's award of damages is reduced to only £1M.

On one hypothesis, C's legal representative could recover £2.5M as the DBA fee, i.e., 50% of the first instance recovery, and then 90% of the amount obtained on appeal [£2.5M + £0.9M = £3.4M]. This reasoning would apply, if the first instance judgment can be considered to be a 'financial benefit obtained by the client', as it represents 'money's worth' (part of the definition of 'financial benefit' in Reg 1(2)), until set aside and reduced on appeal. And the amount on appeal could also be a 'financial benefit obtained by the client', because having been taken to appeal by D, C may have won nothing at all, and thus, the £1M award is better than recovering nothing.

On a second hypothesis, C's legal representative could only recover £500,000 as a DBA fee for the first instance trial and for the appeal, combined, because ultimately all that C obtained, by way of 'financial benefit', was £1M. On this hypothesis, the 50% cap should apply to whatever was ultimately recovered, where the amount awarded at first instance (to which the 50% DBA applies) is reduced on appeal.

On a third hypothesis, C's legal representative could recover £900,000 as a DBA fee, because the 90% DBA for the appeal has overtaken the 50% DBA for first instance proceedings, and £1M is, ultimately, the 'financial benefit obtained by C'.

Scenario #2. C is awarded £5M in a commercial matter at first instance, and again has entered into a 50% DBA with his legal representative. This time, C appeals, and again, a 90% DBA is entered into. C is ultimately awarded a further £1M on appeal, such that his total award, on appeal, is £6M. Presumably, the legal representative can recover a DBA fee of [£2.5M + £0.9M = £3.4M] in this scenario, given that the 50% DBA only applies to the first instance proceedings.

Scenario #3. C is awarded nothing in a commercial matter at first instance, having entered into a 50% DBA with his legal representative. C appeals, and C then enters into a 90% DBA with his representative for the conduct of the appeal, because no DBA cap applies to that appeal. On appeal, C wins, and is awarded damages of £100M. In this scenario, presumably the legal representative can recover a DBA fee of [90% x 100M = £90M], given that the cap at first instance does not apply.

In many respects, the amount of the DBA fee, in any scenario in which an appeal is heard and decided, turns on the fact that the '*financial benefit*' to C must be obtained as a judgment in money or money's worth in favour of C, under Reg 1(2). That opens up the possibility of a '*financial benefit*' being obtained in first instance proceedings — immediately and conclusively — even where an appeal is to be heard thereafter.

3. There is also uncertainty as to the timing of a DBA payment, where an appeal is concerned, i.e., whether the legal representative could take the 50% DBA fee immediately after the first instance proceedings, or whether the DBA fee should not be payable to the legal representative until liability is determined *in toto* after the appeal. Hence, in the scenarios above, could the legal representative recover and bank £2.5M as a DBA fee immediately following the completion of the first instance proceedings?

4. Arguments in favour of the legal representative's being entitled to the DBA fee immediately are that:

- C has '*obtained a financial benefit*' upon conclusion of the first instance proceedings, even if that money is not received until the appeal is concluded;

- law firms are not insurers, and are not obliged to cover C's claim throughout until finality (i.e., the legal representative is not obliged to take on any appeal). Where a further stage of the claim or proceeding is required, then the legal representative should be entitled to 'bank the DBA fee' and renegotiate terms for the continuation of the claim or proceeding;

- C may instruct a different law firm on appeal, and the legal representative who conducted the first instance proceedings ought to be paid for that work undertaken, if a '*financial benefit*' has been obtained by C, in the form of a judgment in his favour;

- an appeal may be filed, but then stayed — and it would be manifestly unfair to C's legal representative if the DBA fee were to be held up, pending a final resolution of the claim or proceedings, because no *'financial benefit*' was received by C, during that stay of appeal.

5. However, arguments against the legal representative's being entitled to the DBA fee immediately after the first instance proceedings are that:

- where the amount awarded is reduced on appeal, the legal representative may be in a position of having to pay a considerable amount of money back to C (per scenario #1 in the box above);

- the Court of Appeal sets aside the original award at first instance, meaning that, technically, no financial benefit is '*obtained*' by C, until the Court of Appeal awards C a different sum; and

- whilst a CFA fee is payable after first instance proceedings, that scenario is different, because the payment there is based upon the hours spent by the legal representative in conducting the first instance proceedings, whereas a DBA fee is not so calculated, but is entirely dependent upon the *'financial benefit*' obtained — and the measure of the '*financial benefit*' may change significantly after an appeal.

6. Some members of the Working Group also considered that the 25% DBA cap applicable to personal injury was too low for first instance proceedings, and that it was entirely untenable that the same 25% cap should apply on any appeal. The low DBA cap for first instance personal injury proceedings was likely to lead to much higher DBA caps being entered into for appeals in that context, in an effort by the legal representative to redress that imbalance. Indeed, in a personal injury case, any legal representative would surely be very unlikely to take on an appeal, if he was only able to claim 25% of specified heads of damage.

7. As the 2015 DBA Regulations are presently drafted, the legal representative could seek to recover for the first instance proceedings under a 50% DBA, but then convert to receiving payment on an hourly rate basis for the appeal stage — or, alternatively, conduct the first instance proceedings on a CFA, but then conduct any appeal under a DBA without cap — given that sequential hybrid DBAs are permissible.

Recommendations

13.1 The Working Group recommended that the philosophy underpinning Reg 4(5) of the 2015 DBA Regulations, i.e., that the statutorily-imposed caps for personal injury and for commercial matters should only apply to first instance decisions, and should not necessarily apply to any appeals conducted from those first instance decisions, should be retained.

13.2(a) A majority of the Working Group recommended that it was **not** necessary for the Regulations to require a 'first instance DBA' to specify whether or not it governed any appeal in the claim or proceedings. Rather, C and his legal representative should be free to negotiate different funding terms for any appeal, whether under a DBA or under some other form of funding (such as a CFA, or an hourly rate basis) — and this negotiation could be conducted either upfront, or at any time during the course of the claim or proceedings (including proximate to the appeal itself). Hence, the DBA for the first instance proceedings could validly remain silent on the issue of any appeal. This was a desirable course, given that: (i) the many and varied circumstances surrounding an appeal were too numerous to be discussed with any surety at the outset of the claim or proceeding; (ii) the legal representative could only feasibly measure the risk of conducting an appeal (and, hence, an appropriate DBA cap for an appeal) when confronted with the prospect of that appeal (e.g., depending upon whether key questions of fact had gone against C at first instance); and (iii) to increase the specified content of the DBA (by specifying what should happen, if an appeal were involved) would ensure yet another point of potential non-compliance with the 2015 DBA Regulations, and increase the prospect of yet another 'costs war'.

13.2(b) A minority of the Working Group considered that the 2015 DBA Regulations should specify that the DBA for first instance proceedings must state explicitly (for the benefit of client C), whether or not an appeal is covered under the DBA. The minority considered that C should know (at a point at which the bargaining position of C and his legal representative were relatively equal) whether or not the DBA caps also covered any appeal in the claim or proceedings, or if so, what those caps should be. According to the minority, disputes about the quantum of the DBA fee (especially if the damages on appeal were reduced) were likely to lead to satellite litigation, if the application of the DBA to appeals was not insisted upon at the outset.

13.3 The Working Group recommends that Reg 4(5) should clarify *the timing* at which the legal representative was entitled to the DBA fee. That is, as a matter of policy, the 2015 DBA Regulations need to clarify whether the DBA fee can be calculated according to the financial benefit obtained at first instance, or whether the DBA fee will always be conditional on the outcome of an appeal (if any).

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14. A COUNSEL'S DBA (AND OTHER ADDITIONAL REPRESENTATIVES)

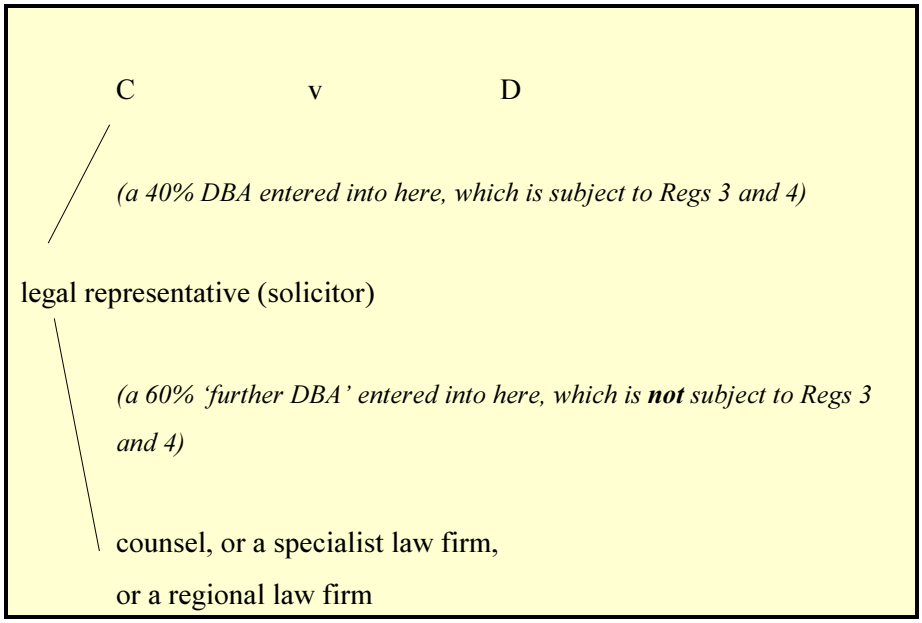
The issue

Two issues have arisen in relation to counsel's use of DBAs, *viz*, the interplay of a counsel's DBA and a solicitor's DBA within the statutory cap; and with whom counsel may enter a DBA.

Discussion points

1. Where counsel is acting for C whereby his fee is to be paid as a disbursement, then that counsel's fee must currently be treated as being **within** the DBA cap — as discussed in issue 1. In Reg 1(2), '*expenses*', which have to be paid by client C in addition to the DBA fee, are said to exclude counsel's fees. This means that the representative's payment, i.e., the DBA fee, includes counsel's fees. This section of the report does not revisit whether counsel's fee, where incurred as a disbursement, should be inside or outside of the DBA cap. Rather, it focusses upon what happens, where counsel is not acting on a disbursements basis, but *is acting on a DBA*.

2. The Working Group considered the ramifications of Reg 5, which provides that '*Regulations 3 and 4 do not apply to a damages-based agreement between a representative and an additional representative*'. The Ministry of Justice indicated that this second DBA could cover a DBA entered into between C's solicitor and counsel. However, the Working Group noted that a DBA '*between a representative and an additional representative*' could also feasibly cover, say, (1) a DBA between a solicitor and a specialist law firm; and (2) a DBA between a regional solicitor and a London law firm who is required to file and serve proceedings on behalf of C. The possible arrangements are shown in the diagram below:



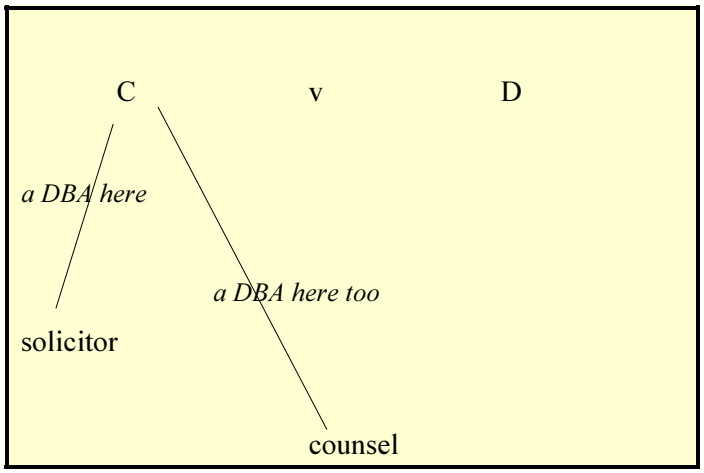
3. The Working Group queried the possibly unintended and adverse-to-C consequences of Reg 5, if Regs 3 and 4 of the 2015 DBA Regulations did not apply to the 'further DBA'. If Regs 3 and 4 did not apply, then **all** of the operative provisions governing DBAs, including the minimum content of the DBA, and the DBA caps, would not apply to that further DBA. Could that mean, then, that a solicitor could recover a 40% DBA fee under the first DBA, but then counsel could recover a DBA fee that was uncapped (say, 60% of the 'financial benefit obtained by C')?

Presumably, the further DBA between solicitor and counsel could be 60%, because it was, essentially, unregulated. But in that case, the most that client C could lose of his damages was 40%. Under the scenario, the solicitor could lose the entirety of his DBA fee, because he would have to pay counsel 60% of the client's recovery, meaning that the solicitor was 'on the hook' to pay counsel more than the solicitor could actually be paid by his client under the DBA — but the Working Group concluded that no solicitor would be inclined to agree those terms of payment with counsel, and hence, the problem was most unlikely to arise. However, there would be no question in this scenario of the client losing all of his damages, because the further DBA fee would need to come out of the solicitor's DBA fee, thus serving to protect the client.

4. A query also arose as to whether the '*additional representative*' referred to in Reg 5 means (1) whoever enters a DBA with a 'first representative' (i.e., whoever enters a DBA with C's immediate solicitor), **or** (2) whoever is appointed by C second-in-time. These options will usually net the same answer — but they

may not, if C's immediate solicitor signs a retainer with C **after** counsel signs an engagement letter directly with C. That is, the formal appointments of the immediate solicitor and of counsel do not necessarily follow chronologically and neatly in the real world of legal practice — the immediate solicitor may be the '*additional representative*' under this interpretation. If this were so, then Reg 5 would presumably not operate as strictly intended.

5. The other problem with Reg 5 is that it is silent about what should occur, if there are separate DBAs between client C and his solicitor, and between client C and his counsel, as follows:



For personal injury and commercial matters, counsel is not prevented from entering into a DBA directly with client C (where counsel undertakes work in a 'direct access' basis). Counsel is permitted to enter a DBA directly with client C, even where a solicitor is also instructed by C, although some Working Group members thought that, in reality, this eventuality was unlikely. In any event, there is nothing under the present drafting of Reg 5 in particular, or of the 2015 DBA Regulations in general, to prevent the solicitor operating on a 50% DBA, and counsel also operating on a 50% DBA, in this scenario.

The Working Group did not consider that this was a desirable outcome, albeit that such a consequence may have been unintended. Rather, Reg 5 should clarify that the combined effect of the first DBA and the further DBA should not exceed the DBA cap (whether 25% for personal injury or 50% for commercial matters). Presumably, there is a public policy imperative for the legal representatives acting for C not to recover, in combination, more than 50% of the financial benefit obtained by C in the action. Otherwise, if the lawyers were entitled, in combination, to >50% of that financial benefit obtained by C, the

inevitable query would arise: for whose benefit is the litigation being conducted? A further provision in Reg 5 was desirable, to cover this scenario and to provide for due application of the DBA caps.

6. Finally, the requirement in the 2015 DBA Regulations, that payment of a representative's costs, '*and, where relevant, disbursements in respect of counsel's fees — will not be the subject of another agreement between the client and the representative*' (per Reg 3(2)(d)(ii)(aa)) is not engaged on the issue which this section of the report considers. That provision is directed to a scenario whereby the same legal representative has entered into simultaneous agreements with the client for the payment of those costs and fees. To the contrary, in the arrangements described in the diagrams above, the legal representative has not entered into more than one agreement *with the client* for payment of his fees/costs, etc.

Recommendations

14.1 Where C enters into separate DBAs with a representative, and with an additional representative directly, then it should be clarified, via a new Reg 5(2), that the DBA fees recovered by the representative and the additional representative should not, in combination, exceed the DBA caps specified in Reg 4.

14.2 On balance, the Working Group did **not** consider that uncertainty would arise as to who is the '*additional representative*', and hence, a clarification of that phrase, either in the definitions section in Reg 1(2) or in Reg 5, was not considered to be necessary.

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15. THE MINIMUM CONTENT OF A DBA

The issue

There is a balance to be struck in specifying the minimum content of a DBA — clarity for the client, versus the risk of unenforceability of the DBA for the legal representative.

Discussion points

1. The Working Group discussed the tension, between specifying enough minimum content in the DBA for clarity's sake, so that the client has sufficient information to understand the way in which the DBA will operate; and not specifying so much minimum content that a technical omission to include something in the DBA will render that non-compliant DBA unenforceable, and hence, result in no recovery by the legal representative for the services performed under the DBA (or even permit a quantum meruit basis of recovery for a reasonable value of services rendered). Given the risk of unenforceability and non-recovery, the Working Group considered that the requirements in respect of a DBA, stipulated in Reg 3, should be as simple, minimalistic, and as transparently clear, as possible.

Matters such as defining what is meant by a 'success' which will trigger the fee being paid, whether it covers appeals, or steps taken to enforce a judgment or order, what happens if a client discontinues or transfers to another lawyer, will still be left for individual negotiation, and should not be specified as minimum content in the Regulations themselves.

2. The Working Group also accepted that, whilst it may be for professional associations to develop and publish a model DBA, which cover matters other than those which are specified as minimum content in Reg 3 of the 2015 DBA Regulations, the reality is that associations will be reluctant to do that, whilst any uncertainty appears on the face of the Regulations.

In any event, this section of the Report is concerned solely with what the minimum content of the DBA should be, failing which the DBA will be unenforceable.

3. Dealing with the requirements in Reg 3 in order:

- Re Reg 3(2)(a), that the DBA must specify 'the claim or proceedings or parts of them to which the agreement relates', the Working Group considered that this minimum content requirement was appropriate, and indeed, necessary, to authorise sequential DBAs. The issue of sequential DBAs is also discussed earlier, under issue 8.

- Re Reg 3(2)(b), opening words, that the DBA must specify '*the circumstances in which the representative's payment, expenses and costs or part of them, are payable*', the Working Group considered this minimum content requirement was both appropriate and necessary (subject to recommendation 11.2 above, in which it is recommended that the phrase, 'and costs', be deleted from the opening words of Reg 3(2)(b)).

- Re Reg 3(2)(b)(i), that the DBA must specify '*the circumstances in which the representative's payment, expenses and costs, or part of them, are payable, including, where relevant, whether the amount of the representative's payment depends upon the stage at which the claim or proceedings are concluded*', this is dealt with under the separate issue, 'Sliding scale payments', in issue 11.

- Re Reg 3(2)(b)(ii), that the DBA must specify '*the circumstances in which the representative's payment, expenses and costs, or part of them, are payable, including a description of the anticipated financial benefit to which the agreement relates*', this requirement is dealt with under the separate issue, 'Obtaining a Money's Worth under the DBA', in issue 19.

- Re Reg 3(2)(c), that the DBA must specify *'the reason for setting the amount of the representative's payment at the level or levels agreed*', this is dealt with under the separate issue, 'Sliding scale payments', in issue 11.

- Re Reg 3(2)(d)(i), that the DBA must specify '*that in respect of the claim or proceedings or parts of them to which the agreement relates, the client will not be required to pay an amount other than*

that prescribed in Reg 4(1)', the Working Group considered this to be unnecessary. What the client must pay is already stated in Reg 4(1), as a substantive requirement of a DBA, and in order to avoid repetition, Reg 3(2)(d)(i) should be deleted. Although the Working Group considered the contrary argument — that stating what the client was required to pay was important for the client's information — the general view was that this would be explained to the client in any event in a client care letter, but was better not included as a mandated term of the DBA itself — bearing in mind that non-compliance would render the whole DBA unenforceable;

- Re Reg 3(2)(d)(ii), that the DBA must specify '*that in respect of the claim or proceedings or parts of them to which the agreement relates, the payment of the representative's costs, expenses and, where relevant, disbursements in respect of counsel's fees — (aa) will not be the subject of another agreement between the client and the representative; and (bb) will not be payable if an agreement or order is not made in favour of the client or if the client does not receive any of the financial benefit stated in the agreement*', the Working Group noted that this clause dealt with **substantive** requirements governing DBAs. Merely stating that these should be articulated in the DBA did not convert them into substantive requirements with which the parties had to comply — all that was required under this clause was that these words needed to be contained somewhere in the DBA. The Working Group appreciated the wish to ensure that the DBA set out certain matters for the information of the client, but was puzzled as to why these should be phrased as necessary content of the DBA, but not as substantive requirements of a DBA, under the 2015 DBA Regulations.

  The Working Group understands that the drafting of this Regulation turns, in part, upon the fact that to render these as substantive requirements of the DBA would go beyond the limits of the *vires* of the Regulations, and that to specify these matters as substantive obligations of a DBA would require a legislative change to s 58AA of the CLSA 1990. (The power to make Regulations is provided for in s 58AA(4) and (5), reproduced in Appendix 2).

  However, be that as it may, the Working Group was of the view that Reg 3(2)(d)(ii) should be deleted, because: (1) the inclusion of such matters did not convert these to substantive requirements, (2) it was yet a further point of risk, that a DBA would not state this, and hence be rendered unenforceable, and (3) the legal representative was already bound by the Solicitors' Code of Conduct, to advise the client about the terms and conditions by which the litigation would be

funded. (It will be recalled that, separately, the Working Group recommended, per recommendation 1.2, that Reg 3(2)(d)(ii)(bb) should be deleted, for separate reasons addressed at p 4 of this Report);

- Re Reg 3(2)(d)(iii), that the DBA must specify that the fact that the client will not be required to pay an amount other than that prescribed by Reg 4(1) and that payment to the representative will not be the subject of another agreement between the client and the representative *'are without prejudice to any terms and conditions in respect of the termination of the agreement*'. The Working Group considered that this clause may be intended to permit the solicitor to charge on some basis (say, an hourly rate for work undertaken) other than a DBA, if the DBA is terminated by the client or (on reasonable grounds) by the solicitor. However, whilst the Working Group considered that such a provision would be useful to stipulate in a DBA, but did not consider that the drafting in Reg 3(2)(d)(iii) was clear enough to achieve that outcome.

Recommendations

15.1 The Working Group recommends that Reg 3(2)(d)(i)–(ii) should be deleted, and any substantive obligations contained therein redrafted accordingly.

15.2 It further recommends that the presumed intent underlying Reg 3(2)(d)(iii) — that in the event of termination of the DBA, the legal representative was entitled to payment under some separate agreement between the client and the representative other than the DBA — should be retained in the 2015 DBA Regulations, but with alternative drafting.

(Other recommendations concerning Reg 3 are contained elsewhere in this Report, as and where appropriate.)

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16. RECOVERY OF COSTS AWARDS WHICH EXCEED THE DBA CAP

The issue

There may be situations where C recovers, by interlocutory or interim costs orders, sums which end up exceeding the contingency fee cap, requiring monies to be repaid to a losing D. This is a direct result of the indemnity principle's continuing application. D may be put in a position where it succeeded in full; or it lost on the claim but succeeded in a counter-claim or via a partial defence, rendering the DBA much lower than anticipated, and requiring interim costs to be repaid to that D.

Discussion points

1. The Working Group explored the possibility that the indemnity principle could put C in a very awkward position, if an interlocutory costs order in C's favour was made. Typically, interim costs awards are to be paid within 14 days of the date of the order. According to the indemnity principle, C is not able to recover more by way of costs from D than it is obliged to pay its own lawyers. If C's claim against D was successful, but less successful than anticipated (say, because of the application of some contributory negligence against C), then the DBA fee may be quite low — and feasibly, the interlocutory costs order may exceed that final DBA fee, meaning that some of the interlocutory costs would have to be paid back to D. Essentially, the DBA fee represents the cap on the recoverable costs which C can obtain from a losing D.

Hence, the Working Group queried whether interlocutory costs orders in C's favour would be stayed in the case of a DBA-funded proceedings. The Working Group also queried what ramification this issue could have on the disclosure of a DBA to the D (given that there is no compulsion, otherwise, for C to inform D of the basis upon which the litigation is being funded). Insofar as pre-1April 2013 litigation was concerned, CFAs and ATE funding had to be disclosed to D because D was obliged (if it lost) to pay the success fee and the ATE premium — but the same considerations do not apply to DBAs, where it is for C to pay his legal representative the DBA fee, plus expenses. The concern was raised that the prospect of

interlocutory awards being made in C's favour might inadvertently 'flush out' the information as to how the claim was being funded.

2. The Ministry of Justice was of the view that, until the case is concluded, there would be no entitlement to any interlocutory costs — so that, if C ultimately succeeded, then any interim costs awards would be payable by the losing D, and would fall within the cap, just as with any other recoverable costs.

The Working Group agreed that, if C were to win an interlocutory hearing on some preliminary point, and wished to apply for its costs of that hearing immediately, that would be impossible, if C's solicitors were operating on a DBA basis. That is because C must file a certified costs schedule, of the costs reasonably incurred in preparing for and conducting that hearing, to claim that interlocutory costs order — but if C were operating on a DBA basis (with no other concurrent basis for payment possible, under the 2015 DBA Regulations), then C could not apply for a costs order at that point, as C could not certify what the standard wording of the certification requires, which is that the costs stated 'do not exceed the costs which [C] is liable to pay in respect of the work which this statement covers'. All of C's recovery is based upon the DBA (out of which recoverable costs are, ultimately, to be carved, but that is for the end of the litigation, and only if C wins the litigation, and ultimately obtains a 'financial benefit' from the litigation).

Hence, C could seek a costs order in its favour, but not seek a summary assessment of those costs; but C would have to say, upon succeeding on the interlocutory hearing, that it was not in a position to certify those costs there and then — which would, in practice, probably flag up to D that the claim or proceedings was being funded on a DBA basis.

Recommendation

16.1 The Working Group had no recommendation to make on this issue, given that a costs order could probably be sought and ordered, but the costs could not be summarily assessed, if C were conducting the litigation on a DBA-funded basis. Hence, the prospect of C's having to pay back some of those costs to D, in order to comply with the indemnity principle, was not going to arise, in practice.

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17. THE HEADS OF DAMAGE FOR PERSONAL INJURY DBAs

The issue

In personal injury claims (as opposed to other claims), the DBA fee only attaches to stipulated heads of damage, excluding future pecuniary losses. The decision to exclude future care costs and other future pecuniary damages was a policy decision — which is not appropriate to review in Phase I of this study. However, the issue arises as to whether, as a matter of drafting, inappropriate heads of damage are being excluded from being subject to the DBA fee.

Discussion points

1. The underlying concern expressed by the Working Group about the use of DBAs in the personal injury context is that a 25% DBA fee, as prescribed in Reg 4(2)(b), is simply too low to make the use of DBAs feasible, for anything other than significant personal injury claims — and this is especially so, when the 25% applies only to restricted heads of damage. The Government's view was that the costs of future care and loss must be excluded from the damages to which the DBA fee will attach — which adhered to Sir Rupert Jackson's recommendation, and is intended to protect C's damages, specifically, those relating to future care and loss. Given the policy decision to restrict those heads of damage to those which is set out in Reg 4(2)(a), then a higher percentage would have been necessary, to make these DBAs provide a viable form of funding. Alternatively, recoverable costs on top of the 25% DBA cap (and not within the DBA cap) may have worked feasibly.

These options for rendering DBAs more utilitarian for personal injury claims are policy issues — or the case for removing personal injury claims from the ambit of the 2015 DBA Regulations altogether — are addressed in Section 30 of the Report.

2. For present 'Phase I' purposes, the Working Group considered whether further attention should be given to drafting the heads of damage to which the DBA fee applies. Presently, under Reg 4(2)(a), it applies

to: '*general damages for pain, suffering, and loss of amenity*', and '*damages for pecuniary loss other than future pecuniary loss*'. This excludes certain heads of damage which have nothing to do with future pecuniary losses, and where it would not infringe the policy reasons given by the Government (of needing to protect future care costs from any DBA deduction), to allow those heads of damage to be subject to a DBA. Such heads of damage may include:

- the 'conventional sum' customarily awarded in cases of wrongful conception, where the personal autonomy of the parental Cs, in wishing to restrict the size of their family, is infringed (per *Rees v Darlington Memorial Hosp NHS Trust* (2003)); and

- an award of aggravated or exemplary damages, which are possible in the case of intentional torts which cause personal injury (e.g., in assault and battery, where, say, a car is used by D as a weapon to mow down C, or in the case of false imprisonment by the police, border detention agencies, or other government officials).

None of these heads of damage pertain to future pecuniary damages, and in that event, it would presumably be acceptable, from the Government's point of view, to allow the DBA fee to attach to them. However, under present drafting in Reg 4(2)(a), that is not possible. Hence, a more elegant way of dealing with the issue may be to reverse the drafting, so as to exclude future pecuniary losses from the damages to which the DBA can apply, but to permit all other damages to be subject to that DBA fee.

However, the Working Group noted that the current drafting in Reg 4(2)(a) of the 2015 DBA Regulations mirrored the arrangement which has applied, for many years, to Conditional Fee Agreements which relate to personal injury claims, where the calculation of the success fee operates similarly upon the types of heads of damage nominated in Reg 4(2)(a) (see, in particular, Reg 5(2) of the Conditional Fee Agreements Order 2013, which replicates the wording in Reg 4(2)(a) of the 2015 DBA Regulations). Thus, for reasons of symmetry, it was discussed whether the legislation governing both DBAs and CFAs should be altered, to permit a wider range of damages to be used for the calculation of the solicitor's remuneration — or whether neither set of legislation should be altered.

Recommendations

17.1 On balance, the Working Group concluded that the 2015 DBA Regulations, in seeking to give effect to the Government's policy position that future pecuniary losses cannot be subject to the DBA, should **not** be redrafted. That is, Reg 4(2)(a) should **not** be recast so as to explicitly provide that the '*sums received by the client from which the representative's payment shall be payable*' should be permitted to include all other damages recoverable by that client (i.e., exemplary damages, conventional sums, etc), other than future pecuniary losses. Symmetry between the method of calculating the DBA fee, and the long-standing method of calculating the success fee under a conditional fee agreement, was considered to be desirable.

17.2 Any further recommendations, regarding the interaction between the 2015 DBA Regulations and personal injury claims, are contained in Section 30 of the Report.

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18. WHERE PERSONAL INJURIES AWARDS ARE ASSESSED AS A LUMP SUM

The issue

Given that the DBA fee applies only to *stipulated* heads of damage in personal injury matters (per Reg 4(2)(a)), then query how that 25% DBA fee is to be calculated, where what is granted to client C for personal injuries is a global sum, and is not broken down into particular heads of damage.

Discussion points

1. Where C receives a court-awarded judgment on quantum, in a personal injury claim, the court will specify the heads of damage, and the calculation of the DBA fee will be straightforward. However, the task is considerably more difficult in settled claims, for no breakdown of the heads of damage may be provided by D, nor agreed between C and D, at all. The Working Group recognised the difficulties in determining the way in which a settlement is divided between general and special damages, and the sums which should be allocated to future pecuniary losses. The Working Group further noted that, whilst C's solicitor will provide C with the best advice that he can as to how the lump sum award of damages is made up, the system was potentially open to abuse, particularly where C's solicitor may be the only legal representative to provide a breakdown of the heads of damage in a settlement. A confirmation of the breakdown of a settlement award is often requested of D, and is often forthcoming in practice. But it may not be.

However, representatives of the personal injury sector on the Working Group were not aware of any abuses which had occurred in the CFA context (i.e., arguments by a 'canny client' that only a small part of the damages payment was for general damages, and hence, the rest would not be subject to the calculation of the success fee). Nor was there any general awareness of disputes between client C and his legal representative as to what part constituted the future pecuniary damages in the CFA context (where the costs of future care were also excluded). It was anticipated that that position could be expected to continue, were DBA-funded personal injury claims to become a reality.

2. The Working Group understands that the Ministry of Justice's view is that C's solicitor will be responsible for ensuring that any settlement with D specifies the sums that are allocated for the general damages to which the DBA can apply, and that C's solicitor is required to act in his client's best interests, and to provide C with appropriate information about costs. The Ministry of Justice has foreshadowed that regulators and/or claimant representative organisations would need to provide guidance as to how to best ensure that any DBA fee payable from damages is properly calculated.

In that regard, members of the Working Group pointed out that APIL's model letters between a personal injury solicitor and the client included a form of dispute resolution (e.g., referral to independent counsel), should certain disputes arise. Hence, there were mechanisms envisaged for the handling of disputes currently, and similarly, these could apply to any dispute which may arise between C's solicitor and C as to the way in which a global settlement sum was broken down, for the purposes of calculating the DBA fee.

Recommendation

18.1 The Working Group considers that the 2015 DBA Regulations should **not** deal with this issue, e.g., by specifying that a breakdown of the heads of damage should be compulsorily undertaken in any global settlement sum. Rather, the division among heads of damages in a global settlement sum should be dealt with as between C and his solicitor, given that: (1) it was inherent in the solicitor's professional duties that he must act in the interests of C at all times (failing which sanctions may ensue); and (2) failing agreement between C and his solicitor as to an appropriate breakdown, other forms of dispute resolution (e.g., a referral about an appropriate breakdown of the settlement sum to an independent third party) were already countenanced in professional organisations' guidelines or model letters. Hence, it was unnecessary for the 2015 DBA Regulations to deal with the issue.

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19. USING DBAs WHERE 'MONEY'S WORTH' IS OBTAINED

The issue

The question arises as to whether a DBA could be used in non-monetary claims, such as in testamentary or in *inter vivos* trusts disputes — or where shares or a part of a goldmine, say, are at issue — so that property, and not money, is recovered on behalf of C.

Discussion points

1. The DBA fee is calculated as a percentage '*of the financial benefit obtained by the client*' (in Reg 4). In revised drafting in the 2015 DBA Regulations, a new phrase, '*financial benefit*' appears, which is defined in Reg 1(2), to '*include money or money's worth*'. This was necessary, given that the 2013 DBA Regulations referred only to 'the sum recovered in respect of the claim or damages awarded', i.e., monetary recovery — whereas the overarching DBA definition in s 58AA of the CLSA 1990 envisaged that '*the recipient obtains a specified financial benefit*', which could be something other than the recovery of money.

The Working Group considered that various manifestations of non-monetary recovery by C — e.g., the retention of shares in a company, the acquisition of a share of a mine or a share of a trust or an estate, the preservation of a patent with the consequential goodwill that flows from defeating a competitor's use of that patent, the acquisition of a painting, the achievement of injunctive relief which prevented the ongoing infringement of C's trademark — could all fall within '*money's worth*'. In the Working Group's opinion, the new definition of '*financial benefit*' was entirely suitable to catch these types of scenarios.

2. However, the Working Group considered that, where the anticipated '*financial benefit*' was to be '*money's worth*' and not a monetary sum, then a difficulty arises, '50% of **what**'? How is that to be stated in the DBA? The overarching definition of a DBA in s 58AA(3)(a)(i) of the CLSA 1990 refers to the recipient obtaining a '*specified financial benefit*', but the Working Group did not consider that this necessarily required the DBA to state, upfront, the precise monetary amount of that benefit.

Further, the requirement, in Reg 3(2)(b)(ii) requires that the DBA must specify '*a description of the anticipated financial benefit to which the agreement relates*'. However, the Working Group did not consider that this phrase compelled the DBA to specify either the amount or a formulaic equation necessary for the assessment of the '*money's worth*'.

Therefore, it was considered that the 2015 DBA Regulations should specify that the DBA must stipulate **either** the value (in £££) of the '*money's worth*' which represents the '*financial benefit*' obtained by C; **or** alternatively, some formula by which the value was to be quantified (if necessary, by reference to an independent third party's opinion of its value). In other words, there should be some mechanism whereby the value of the '*money's worth*' was set out in the DBA. Otherwise, disputes down the track, as to the DBA fee to which the legal representative was entitled, could foreseeably arise. The Working Group considered that, in some of the examples of '*money's worth*' noted in para 1 above (e.g., the successful protection of a patent), a pre-determined assessment of what the thing recovered was worth might be absolutely impossible when the DBA is being drafted at the outset — the formulaic approach was far more likely.

The Working Group also considered that the 2015 DBA Regulations should require the DBA to state the date at which the valuation of the '*financial benefit*' should occur. The valuation could vary significantly, depending upon whether it was undertaken at the date of judgment or settlement, at the date of execution of the judgment, or at some other time.

3. Regarding the requirement in Reg 3(2)(b)(ii), the Working Group was initially divided as to whether '*a description of the anticipated financial benefit to which the agreement relates*' provided the sort of meaningful certainty which presumably it was intended to give the client, or enabled the legal representative to comply properly with that requirement. The phrase, '*description*', was also criticised as being unclear — especially where the claim or proceedings could have, as its object, the recovery of damages, the recovery of tangible assets such as two paintings, the achievement of injunctive relief which obtained an intangible benefit such as goodwill, or a combination of any of these. It was also pointed out that, under Reg 3(2)(b)(ii), the DBA must look prospectively as to what the 'anticipated financial benefit' would be; whereas the DBA must also specify, under Reg 4(4), that the representative's payment must not exceed '50% of the financial benefit obtained by the client', which entailed a retrospective assessment of what was actually obtained — and under the current drafting of the 2015 DBA Regulations, both must be specified.

On balance, the Working Group considered that it would be possible to phrase a relevant clause in the DBA that met with the requirement in Reg 3(2)(b)(ii), and that it provided some important measure of information and clarity for C. It would also assist, in the case of a Defendant DBA, to describe the anticipated financial benefit as the anticipated savings, should D successfully defend the action. Hence, and despite the misgivings noted above, the Working Group considered that the sub-Regulation should be retained.

4. There may also be a potential problem with the drafting in Reg 4(4), which refers to payment *'which ... is equal to 50% of the financial benefit obtained by the client*'. Given that the financial may be two paintings acquired from D, it may be better to refer to *'50% of the value of the financial benefit obtained by the client*', given that '*financial benefit*' can mean '*money's worth*' — and presumably the legal representative would not need to take one of the paintings, by way of DBA fee.

Recommendations

19.1 The new definition of '*financial benefit*' in Reg 1(2), to '*include money or money's worth*', was sufficient to cover a myriad of circumstances where what is recovered by C is some tangible or intangible asset, other than money. However, the Working Group recommends that the 2015 DBA Regulations should specify that, where the '*financial benefit*' to which the DBA relates is represented by '*money's worth*', then the DBA must stipulate **either** the value (as a monetary figure) of that '*financial benefit*', **or** alternatively, some formula by which the value of that '*financial benefit*' is to be quantified (if necessary, by reference to a valuation undertaken by an independent third party). In the latter case, the date of valuation of the '*financial benefit*' should also be stipulated in the DBA.

19.2 The requirement, in Reg 3(2)(b)(ii), that the DBA must specify '*a description of the anticipated financial benefit to which the agreement relates*', was not considered to be specific enough to cover the suggested mandated content of the DBA noted in recommendation 19.1, above. Nevertheless, the Working Group considered that, on balance, Reg 3(2)(b)(ii) should be retained in the 2015 DBA Regulations, as it provided information to the client, as to whether the recovery was damages, something else which represents '*money's worth*', or a combination of the two.

19.3 In Reg 4(4), the Working Group recommends that it should be redrafted, to state as follows: ' ... a damages-based agreement must not provide for a *representative's* payment which, including VAT, is equal to 50% of the *value of the* financial benefit obtained by the client'.

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20. THE LEGAL REPRESENTATIVE'S POSITION, REGARDING RECOVERABLE COSTS AND EXPENSES/DISBURSEMENTS

The issue

The Working Group was concerned about the protections (or lack thereof) afforded to both the consumer and the legal representative in two respects, under the 2015 DBA Regulations — one is in respect of recoverable costs, and the other is in respect of liability for disbursements.

Discussion points

1. As presently worded, Reg 4(1) of the 2015 DBA Regulations provides that the DBA can only require the client to pay to the representative the representative's payment, net of recoverable costs, counsel's fees, and expenses.

However, the provision says nothing about whether the client can agree with the representative that the representative will be paid the recoverable costs, counsel's fees, and expenses recovered from the losing opponent *directly*. That sort of arrangement was presumably contemplated by the drafting of Reg 4(1) — but the costs order will be made in the client's favour, not in favour of the legal representative. What if the client refuses to pay over those recoverable costs to the legal representative? The present wording arguably means that the DBA itself cannot require the client to agree that the recoverable costs, counsel's fees and expenses recovered from the losing opponent will be paid to the solicitor. That should be clarified, by a redrafting of Reg 4(1).

2. The Working Group was concerned that, as presently drafted in Reg 3(2)(d)(ii)(bb), the expenses and counsel's fees incurred in the conduct of the litigation are not payable, if client C *'does not receive any of the financial benefit stated in the [DBA]*'. At least, that is what the DBA itself must state, as the Regulation is presently drafted. (It has been recommended elsewhere that this clause be deleted, and that

if this clause is to be converted to a substantive requirement of the DBA Regulations, as opposed merely to something that must be incorporated in the DBA itself, that will need to be drafted accordingly.)

In any event, the ethos behind Reg 3(2)(d)(ii)(bb) appears to be very unfair to the legal representative, for it is one thing for the client not to have to pay the DBA fee if the case is lost — that much is understandable. But as it stands, Reg 3(2)(d)(ii)(bb) leaves the solicitor 'on the hook' for all expenses, including for counsel's fees, if C loses the case. The client himself is exculpated from having to pay for these too. If that drafting remains as is, this is likely to be a great disincentive for any legal representative thinking of funding a case on a DBA. It would mean that the solicitor, and not the client, would have to pay any expert's fees, court fees, etc , that were incurred by the solicitor in conducting the case to an unsuccessful outcome (and which the solicitor had not insisted that the client contract to pay directly). Hence, the Working Group considers that it should be open to the solicitor and the client to agree that the client is liable for both expenses and for counsel's fees, whether the client succeeds or loses in the case. (The only exception would be where counsel is also acting on a DBA basis).

There is also a somewhat odd ramification of the way in which Reg 3(2)(d)(ii)(bb) is currently drafted, in that if the client receives something, no matter how small, by way of '*financial benefit*', then the client must pay the expenses, because the phraseology refers to the client not having to pay anything if he *'does not receive **any** of the financial benefit*'.

Recommendations

20.1 Reg 4(1) of the 2015 DBA Regulations could be simplified (amended as shown in bold), to provide that:

In respect of any claim or proceedings or parts of them to which these Regulations apply, a damage-based agreement must not require an amount to be paid by the client other than—

(a) the representative's payment, and

(b) any disbursements,

net of any sum in respect of the client's legal fees, costs or disbursements which has been paid or is payable by another party to the claim or proceedings.

20.2 The 2015 DBA Regulations should be clarified, to provide that the representative and the client may agree that, regardless of whether or not C receives any financial benefit in the claim or proceedings, the client is obliged to pay the disbursements incurred in the conduct of that claim or proceedings.

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POLICY ISSUES

21. PRECLUDING CONCURRENT HYBRID DAMAGES-BASED AGREEMENTS

The issue

In Section 8 of the Report, the Working Group focused upon the type of hybrid DBA which permits a *sequential* form of funding, and which does not offend the Government's policy. The Working Group understands that the Government considers that it is not unreasonable for a solicitor to use one form of funding (e.g., an hourly rate) for one stage of the proceedings (i.e., to investigate the merits of the case, or to obtain expert reports), and then use another form of funding (i.e., a DBA) for other stages of the claim.

However, it is **against** present Governmental policy to permit *concurrent* hybrid DBAs. These types of DBAs will occur where the legal representative may potentially receive funding, via both a percentage of recovery and via some other form of retainer (e.g., by hourly rates), either without allocating the relevant legal work as between one form of funding or another (in the event of the claim's success), or recovering the hourly-rate fees even if the claim is lost. The Working Group considered whether concurrent hybrid DBAs should be permitted, despite present Governmental policy.

Discussion points

1. The Working Group noted the description of a hybrid DBA which was adopted by Lord Justice Jackson in his Law Society conference presentation, *Commercial Litigation: The Post-Jackson World*: a 'hybrid DBA' means '*an agreement under which the client pays its lawyers a low fee if the action is lost, and a percentage of the winnings if the action is won*' (per para 3.6). These are typically referred to as 'no win, low fee' DBA agreements.

The Working Group understood a concurrent hybrid DBA, as intended by the Government, to mean that, if the case ultimately fails, the legal representative can be paid his base costs (via, say, a discounted hourly rate) as the case goes along. It also means that, if the case succeeds, then the legal representative is

entitled to both those base costs, plus the DBA fee calculated by a percentage of the damages recovered by the client.

2. The Working Group understands that the Government is opposed to concurrent hybrid DBAs for several reasons:

i. if a client can afford to pay base costs as the action proceeds, even if the action ultimately loses, then the Government's view is that such a client can use alternative funding arrangements to DBAs;

ii. the particular objection to concurrent hybrid DBAs is that to endorse them would be to increase the remuneration for the lawyers, whilst minimising the risks incurred by those lawyers in achieving those returns. In other words, the Government fears that concurrent hybrid DBAs offer lucrative opportunities for lawyers to increase their earnings greatly from conducting a case, without a commensurate increase in risk. The Government is keen to ensure that DBA reform does not encourage the sort of less-than-meritorious litigation which it is keen to discourage, and which might be promoted if lawyers were incentivised to bring claims, knowing that they were to obtain some return, even if the case lost, and would yield very handsome returns if the case won (especially in commercial litigation, where the DBA cap is statutorily-set at 50%);

iii. the Government also draws a distinction between hybrid DBAs, and 'no win, low fee CFAs' (hereafter, 'hybrid CFAs'). In *Gloucester CC v Evans* [2008] EWCA Civ 21, the Court of Appeal permitted hybrid CFAs, pursuant to which a solicitor can charge a reduced rate (i.e., base costs) to his client, in the event that the claim is unsuccessful. However, if the claim succeeds, the solicitor can claim a success fee, in addition to the base costs. Either way, the solicitor can receive some payment as the case progresses. However, the point (according to the Government's view) is that the fee due under a CFA is generally in proportion to the work actually done, as the success fee relates to the work done, and is capable of being independently assessed on a costs assessment. However, under DBAs, by definition, the DBA fee recoverable by the solicitor is not referable to the amount of legal work done, but is related only to the damages recovered, which may be substantial. The

Government draws this important distinction between hybrid CFAs and concurrent hybrid DBAs;

iv. the Government is concerned about a new 'costs war', and/or increases in speculative litigation which would not otherwise be taken forward, of the sort which developed, as an unintended consequence of the Access to Justice Act 1999, after the implementation of CFAs. That experience was scarring — and, in a similar way, DBAs are a new form of funding, and the Government is concerned to ensure that they develop carefully and cautiously. Hence, the Government's preference is that concurrent hybrid DBAs should be considered as part of the scheduled review of the LASPO post-implementation review in 2016–18; and

v. the Government's view is that DBAs are not intended to fill any 'access to justice' gap. Rather, they are intended to constitute an alternative form of funding in (unspecified) niche areas of litigation — apart from commercial litigation, where (in the Government's view) solicitors will have other means of funding meritorious cases.

3. However, by contrast, the Working Group took note of the reasons as to why Lord Justice Jackson has argued that concurrent hybrid DBAs **should** be permitted. To summarise those, from his keynote speech delivered to the Law Society, *Commercial Litigation: The Post-Jackson World*, at paras 3.7–3.16:

i. DBA funding is particularly suited to long-running, high-risk commercial litigation, where some funding as the case proceeds would make the case more viable to take on;

ii. D is not affected, whether C's case is funded by a sole DBA, a hybrid DBA, or via a CFA. D is not paying any success fee, or any component of C's DBA fee — that is solely coming out of C's recovery of damages. Hence, how C chooses to fund his litigation is his own concern, and no business of D's;

iii. hybrid DBAs are permitted in Canada (per s 28.1(2) of the Solicitors Act), and have not caused any problems. Rather, the effect of that regime has been to increase access to justice;

iv. hybrid DBAs are permitted in other jurisdictions too (e.g., the Netherlands), where a client must pay some portion of legal costs in the event of that party losing the case;

v. CFAs may be used in discounted 'hybrid' form, and it is illogical not to permit DBA funding to have that same flexibility. No-won-low-fee funding agreements should be permitted in **both** contexts;

vi. Third Party Funders are permitted to fund cases on a hybrid basis, whereby they may fund some or all of the litigation costs, even if the case fails, and they receive a share of the damages if the action succeeds. Hence, there is a precedent, where contingent funding is concerned. And indeed, DBAs are a more efficient form of funding, as there are only two parties in play (client and legal representative), and not three parties (those two, plus a Funder). Hence, DBAs should not be subservient to Third Party Funding;

vii. hybrid DBAs are very unlikely to encourage frivolous and speculative litigation, because if the legal representative is also 'investing' in the case, then he is unlikely to do so, if the case is weak; and

viii. permitting hybrid DBAs would enhance access to justice, and given the LASPO reforms, post 1 April 2013, especially the non-recoverability of the success fee, then the more funding options open to C, the better.

4. The Working Group made two points about policy and concurrent hybrid DBAs:

i. Third Party Funders offer a form of 'hybrid DBA' (as discussed in detail in Section 9 of the Report). This form of 'hybrid' apparently does not offend Government policy, even though it is aimed at achieving, from the legal representative's perspective, precisely the same result as a concurrent hybrid DBA — *viz*, the legal representative will be paid a low fee if the action is lost, and a percentage of winnings if the action is won (because the legal representative, in effect, trades part of the contingent DBA payment for a guaranteed ongoing fee from the Funder).

The only difference is that, under a Funder's hybrid DBA, the client has a full 'no win, low fee' DBA with the law firm, but the deal between the law firm and the Funder achieves for the law firm an equivalent result to a concurrent hybrid DBA, *viz*, some funds to pay for the work-in-progress incurred during the conduct of the case. Hence, if a Funder's hybrid DBA is permitted, then it is difficult to perceive of any policy reason to ban concurrent hybrid DBAs for a law firm.

ii. the so-called sequential hybrid DBAs (discussed in Section 8 of the Report) do not offend Government policy either. And again, it is difficult to perceive of any policy justification for allowing different forms of retainer, with different funding mechanisms, for different parts of an action (which, howsoever defined, is itself a very difficult issue, as described in Section 8), but to disallow a hybrid DBA retainer which combines different forms of funding. The Working Group noted that any attempt to draft Regulations to permit one but to ban the other, with clarity as to what is/is not permitted, is likely to be very challenging, and lead to potential satellite litigation.

5. The Working Group noted that this issue has assumed huge importance in the legal marketplace, in that without concurrent hybrid DBAs, lawyers may not see DBAs as being attractive enough to encourage them to take on C's cases. This reluctance is heightened by the innate conservatism of the legal profession. In particular, the uncertainty as to whether or not concurrent hybrid DBAs are permissible has had an incredibly chilling effect on the take-up of DBAs. If the Government wishes to ban their use, then it owes it to the legal marketplace to make that entirely plain, via its revised drafting of the 2015 DBA Regulations. But if it accepts the arguments in favour of concurrent hybrid DBAs, then similarly, the drafting must reflect that. The present state of uncertainty cannot be allowed to continue.

6. The Working Group also noted that concurrent hybrid DBAs may be better suited to some areas of legal practice than others, such as personal injury claims. Also, they may be quite suited to commercial cases which are litigated (at the considerable expense of both sides) over several years.

7. The Working Group concluded that it was difficult to assemble any evidence, either way (whether from legal representatives or from clients), as to whether concurrent hybrid DBAs would have a positive or a negative effect on access to justice/efficiency of litigation. There was simply an insufficient cadre of

examples to draw upon, given the marketplace's nervousness about whether or not concurrent hybrid DBAs were enforceable. However, the Working Group noted that it was certainly conceivable that there will be cases that are meritorious, but which are highly complex or costly to conduct, and which C's legal representative would be prepared to take on under a hybrid DBA, but not on a full 'no win, no fee' DBA (because of the level of risk), nor on a CFA (because the rewards are not sufficiently favourable). Accordingly, permitting hybrid DBAs may provide access to justice in these cases.

Recommendation

21.1 The Working Group was divided on the question of concurrent hybrid DBAs, with some members considering that there was no good reason to prohibit their use, and that market freedom should prevail; whilst other members considered that the case in favour of concurrent hybrid DBAs had not been proven. It concluded that it was a policy decision which was ultimately one for the Government. However, the Government should be encouraged to evaluate the arguments in favour of concurrent hybrid DBAs, even in the absence of any cadre of cases which have tested the arguments (given the nervousness of the legal marketplace on this issue).

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22. THE 'SUCCESS FEE' MODEL

The issue

The Working Group acknowledged (from Phase I's work) the multiple difficulties which apply under the so-called 'Ontario model' (whereby recoverable costs are included within the DBA cap), and considered whether the 'Success Fee' model would warrant reconsideration, under the 2015 DBA Regulations. The main issue is the treatment of recoverable costs, and whether those should be within, or outside of, the DBA cap.

Discussion points

1. The key difference between the 'Ontario model' and the 'Success Fee' model was explained in the example provided in the Glossary and Terminology (at pp x–xi). Under the Ontario model, the recoverable fees are to be deducted from the contingency fee, so that the most that the legal representative can retain, in the event of the claim's success, is the contingency fee cap. Under the Success Fee model, however, the calculation is quite different. The contingency fee is to be treated as the success fee, which can be retained by the legal representative, on top of the recoverable costs awarded.

Under the Success Fee model, obviously the legal representative recovers more (and the funded client retains less) than under the Ontario model (if the percentage cap remains the same). It will be recalled that, in the aforementioned example, C recovered £95,000 under the Ontario model, and recovered £75,000 under the Success Fee model.

It was the Ontario model which was ultimately implemented in the 2013 DBA Regulations for both personal injury and commercial matters (in the general absence of costs-shifting in the Employment Tribunal, the issue does not arise for consideration in employment matters). Clearly, the ramification of the Ontario model is that the client's representative cannot treat the contingency fee as a true 'success fee', on top of the recoverable costs incurred to successfully prosecute the claim. The drafters of the 2013 DBA Regulations

confirmed this in the accompanying *Explanatory Memorandum* to that SI: '*[t]he DBA principles are based on the lawyer not being able to recover any more than the DBA fee*' (per para 4.5).

2. The benefits of the Success Fee model are as follows:

i. it would avoid the consequences of the indemnity principle (discussed in Section 23), and any consequential windfalls for D. Under that principle, a losing D cannot be ordered to pay more in recoverable costs than C is obliged to pay his own solicitor. However, if the recoverable costs are on top of the contingency fee, and not part of that fee, then D will always be liable to pay the recoverable costs. By contrast, under the Ontario model, the contingency fee cap may be 'eaten up' by recoverable costs, and any recoverable costs which are in excess of that DBA fee will not need to be paid by D — providing D with a windfall. Essentially, when recoverable costs are treated as being within the DBA cap, then some cases will be very unprofitable indeed under the 2013 DBA Regulations, and a high costs-to-damages ratio brings the indemnity principle into play more frequently, under the Ontario model;

ii. the Success Fee model would particularly enhance access to justice in low-value claims. Where the recoverable costs for a claim are proportionately quite high, compared with the DBA fee, then the viability of the claim correspondingly reduces, as it is the legal representative's 'profit' in successfully prosecuting the case which is being 'eaten up'.

This point was particularly made by Sheriff Principal Taylor in his report, *Expenses and Funding of Civil Litigation in Scotland* (2013). In its follow-up consultation on that report, the Scottish Government noted, in its *Consultation on Expenses and Funding of Civil Litigation Bill* (Jan 2015), that it was willing to accept Sheriff Principal Taylor's recommendation of implementing the Success Fee model as part of its prospective DBA reform.

The reasons for that Governmental policy decision in Scotland are instructive (at [52]–[55]): '*Sheriff Principal Taylor considered that a consequence of requiring solicitors to offset judicial expenses [recoverable costs] against the success fee, as is the case in*

England and Wales, was that they would receive far less remuneration than they would under a speculative fee agreement, in which the solicitor can retain judicial expenses and in addition charge a success fee. He found it difficult to see why solicitors should choose to offer damages based agreements, particularly in lower value cases, when they would receive considerably less than they presently do under speculative fee agreements if the action succeeds, and nothing at all should the action fail. He concluded that solicitors should not be obliged to offset the judicial expenses against the success fee to which they are entitled. The purpose of allowing them to keep both was to encourage solicitors to offer damages based agreements in low value cases. ... We intend to legislate to allow damages-based agreements to be enforceable by solicitors in Scotland ... We also intend to provide that solicitors should be entitled to retain judicial expenses recovered from the defender, in addition to recovering the agreed success fee from their clients. We agree that this would encourage solicitors to offer damages based agreements in lower value cases.'

iii. it is likely that the Success Fee model is conceptually easier to explain to a client. The intricacies of the indemnity principle must be properly understood by the client, where the Ontario model applies. Furthermore, an explanation of what is within and outside of the cap is further complicated by the inclusion of recoverable costs within the cap, when that is the component which is most likely to consume a lot of the DBA cap; and that explanation is already complicated enough.

3. The disadvantages of the Success Fee model are as follows:

i. the Ontario model has the virtue of stating this: 'the DBA cap represents the most that the legal representative can gain; and is the most that C can lose' (albeit that, under the Ontario model, C will almost never actually lose the amount of the DBA cap, because recoverable costs will be deducted from that cap — unless, for some reason, there are no recoverable costs);

ii. the Ontario model represents a cap on the recoverable costs which D is obliged to pay, and on that basis, it upholds the indemnity principle. On the other hand, as explained in 2i.

above, the Success Fee avoids the consequences of the indemnity principle, and any consequential windfalls for D (i.e., recoverable costs that do not have to be paid to C).

4. The Working Group took note of the fact that the Government's policy decision to adopt the Ontario model for the 2013 DBA Regulations was made quite 'late in the day', during the reform process. When a draft set of DBA Regulations were produced in 2012, they appeared to implement the Ontario model for personal injury litigation, and the success fee model for commercial matters. However, that differentiation was presumably unintended, for it was removed in the 2013 DBA Regulations.

Prior to the drafting and implementation of the 2013 DBA Regulations, there was no conclusive indication, in several important policy documents, as to whether it was anticipated that the Ontario model or the Success Fee model would be applied under the DBA regime — and what indications there were, were quite mixed and inconclusive.

In its paper of 2011, *Proposals for Reform of Civil Litigation Funding and Costs in England and Wales*, which constituted the MOJ's response to Sir Rupert Jackson's Final Report, *Review of Civil Litigation Costs*, the MOJ did not expressly deal with how recoverable costs were to be treated under the proposed DBA regime. The most that it said was that, '*DBAs therefore allow representatives to claim a proportion of their client's award of damages as their fee, and are therefore suitable mainly for use in cases where [C] receives damages or some other specified financial benefit*' (at [221]). However, this sentence did not suggest whether recoverable costs were inside, or outside of, the DBA cap. To the contrary, the Lord Chancellor's response to the Jackson report endorsed the Ontario model: '*in the case of a DBA, the costs recovered from the losing side would be set off against the DBA fee, reducing the amount payable by [C] to any shortfall between the costs recovered and the DBA fee*' (Mar 2011, Conclusion #13). The Hansard debate which accompanied the passage of LASPO 2013 was not, however, particularly helpful. The DBA regime was contained in cl 42, of which Jonathan Djanogly MP (the lead Justice Minister of this legislative initiative) stated (per HC *Hansard*, Public Bills Committee, 13 Sep 2011, col 556): '*[C's] solicitor might agree to fund disbursements in exchange for an increased success fee or an increased share of the damages, where [C] uses a DBA, which we propose to permit for all civil litigation in cl 42.*' The reference to 'success fee' might have contemplated the Success Fee model, but the reference was not conclusive. Nor did the *Explanatory Notes* which accompanied the LASPO Bill clarify the matter, one way or the other. In the Jackson report too, there was no explicit discussion of what ought to occur about recoverable costs, except

for reference to '*the satisfactory Canadian experience of contingency fee agreements in personal injury cases*' (*Review of Civil Litigation Costs* (Dec 2009), ch 12, [4.11]).

The earliest explicit consideration of the choice between the Success Fee model and the Ontario model appears to have occurred in the CJC Working Party's *Report on Damages-Based Agreements* (2013). That Working Party was tasked with reviewing draft DBA Regulations in 2012 and with making recommendations to Government about them. The Working Party recommended (by majority) that the Ontario model should apply (per para 5), with the caveat that '*care will need to be taken, in determining precisely what elements of unrecovered costs (solicitor's fees, counsel's fees, VAT, ATE premium, and disbursements) may be taken from the contingency fee, after prior deduction of recovered base costs and disbursements*'. (For the sake of transparency, it should be noted that the Chair of this current Working Group, Prof. Rachael Mulheron, was a member of that earlier CJC Working Party.)

Hence, there was no clear or longstanding policy choice to implement the Ontario model until quite late in the reform process, and the time constraints at that time were such that the respective merits/demerits of the two models could not be properly put to consultation in the marketplace. For that reason, a more considered view of which model warrants incorporation in the 2015 DBA Regulations may be warranted.

5. The current Working Group noted that, were the Success Fee to apply, then what counted as a 'success' would require careful articulation in the DBA itself, as that would conceivably provide the trigger to C's entitlement to recoverable costs. (To emphasise, defining '*success*' is not the province of the DBA Regulations, but is a matter for the agreement itself.)

For example, suppose that C won an interlocutory application that certain documents held by D be disclosed. That could be defined as a 'success' at an interim stage; and suppose that the recoverable costs associated with that application were £500. Hence, even if C did not win the case overall, it is arguable that £500 of recoverable costs should be paid to C.

6. If the Success Fee model were to be implemented, in place of the Ontario model, in the 2015 DBA Regulations, some members of the Working Group opined that the *quid pro quo* was that lower statutory caps might be appropriate (especially for commercial litigation, where the current statutory cap is 50%), if

recoverable costs were to be recovered on top of the DBA fee, to preclude an inordinately-large recovery by the legal representative in such a case.

Recommendation

22.1 Most members of the Working Group favoured the implementation of the Success Fee model, in preference to the Ontario model, given the several advantages which the Success Fee model entails. Certainly, whether the Ontario model or the Success Fee model should be implemented, by which to govern recoverable costs, should warrant a review of Governmental policy, given the advantages which accrue with the Success Fee model. However, if the Success Fee model were to be implemented, the statutorily-set ceilings may require reducing.

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23. THE INDEMNITY PRINCIPLE

The issue

The indemnity principle, which derived originally from English common law but was then put on a statutory footing in s 60(3) of the Solicitors Act 1974, applies as equally to DBA arrangements as to any other civil litigation. The question arises as to whether it should be abrogated under the proposed 2015 DBA Regulations.

Discussion points

1. Under the indemnity principle, D cannot be ordered to pay more, in recoverable costs, than C is obliged to pay his legal representative. Section 60(3) puts it this way: '*A client shall not be entitled to recover from any other person under an order for the payment of any costs to which a contentious business agreement relates more than the amount payable by him to his solicitor in respect of those costs under the agreement.*'

In the DBA context, the DBA payment or fee represents a ceiling on the recoverable costs to which C is entitled. In order to succeed in a claim against D for recoverable costs, C must establish that he is under a liability to pay these costs to his legal representative by reason of an enforceable DBA. As confirmed recently in *Brookes v DC Leisure Management Ltd* [2013] EW Misc 17 (CC) [19], '*[t]here is no doubt that this (the indemnity principle) remains a part of English law*'.

2. The Government's clear policy is that the indemnity principle applies under the 2013 DBA Regulations. In its memo dated November 2012, the Ministry of Justice stated that, '*[t]he indemnity principle will apply, so that a party may not recover, by way of costs, more than the total amount payable by that party under the damages-based agreement*' (see, 'Legal Update: Update to MOJ webpage on Jackson Implementation', at: <www.justice.gov.uk/civil-justice-reforms>). The drafters of the 2013 DBA Regulations confirmed this in the accompanying *Explanatory Memorandum* to that SI (at [7.11]).

3. The consequence of the principle's application to DBAs is that if the whole of the DBA payment is 'consumed' by recoverable costs, then the client has nothing further to pay the legal representative (other than any irrecoverable expenses which lie outside that contingency fee cap, as outlined in Section 2 of the Report). Also, if the amount of recoverable costs exceeds the DBA cap (or the agreed DBA fee if that is lower than the cap), then the most that C's legal representative can recover from D, by way of recoverable costs, is an amount equal to the DBA fee — no matter what recoverable costs C's legal representative *actually* incurred in recovering the damages for the client. Any excess recoverable costs, over and above that DBA cap, will be retained by D.

4. The Government's response to the concerns which the indemnity principle may cause C's legal representative, when using a DBA, was blunt: '*[i]t will be for [C's] legal representative in these cases to consider his likely costs before reaching agreement as regards the payment to be made from the claimant's damages*' (per *Explanatory Memorandum* to the 2013 DBA Regulations, [7.10]). This statement may tend to underplay the fact that C's legal representative does not have an unfettered choice as to the DBA fee which he is able to contractually negotiate — the maximum caps are statutorily set as 25% for personal injury, and 50% for commercial matters (and moreover, the Working Group was of the view that rarely will commercial clients with high value claims agree to a DBA fee of 50%). Moreover, the duration of the case, and the work required for it, are not always capable of a precise enough determination, at the outset, to determine whether or not the DBA fee will be entirely consumed by recoverable costs.

5. The Working Group considered the various advantages and benefits that would accrue, should the indemnity principle be <u>disapplied</u> to DBA arrangements:

i. the indemnity principle, where it applies, gives rise to a potential windfall accruing to D — take the following example:

- C recovers £1M in damages;
- the agreed DBA fee is 50%;
- the DBA payment to which C's legal representative is entitled is £500,000;
- recoverable costs are assessed at £600,000;
- hence, the amount recoverable by C's legal representative is £500,000;
- the sum of £100,000 is retained by D, even though it was assessed as being recoverable costs;

- C himself is entitled to retain £1M of the damages (the DBA fee owed by him to his legal representative having been entirely consumed by recoverable costs).

The windfall potential to D is the biggest argument in favour of abolishing the indemnity principle, in the Working Group's view. This view was also noted by Lord Justice Jackson, in his report, *Review of Civil Litigation Costs* (Dec 2009): the indemnity principle '*sometimes enables unsuccessful parties to escape liability for costs on what may be seen as technical grounds*' (at [5.1.1]). Indeed, one of the reasons that Lord Justice Jackson recommended that the indemnity principle be abrogated across **all** litigation was that, '*[o]n occasions, the indemnity principle has enabled liability insurers to gain windfalls. They have knocked out altogether claims for costs in respect of work properly and competently done on behalf of successful claimants*' (at [5.3.4(ii)]).

ii. abolishing the indemnity principle would remove one risk for C's legal representative, where the likely recoverable costs incurred during the case may not be easy to evaluate at the outset of the action when the DBA is being entered into (where the strength of merits of the action, or the merits of a defence, are hard to assess, prior to disclosure occurring);

iii. D has less motivation to challenge the enforceability of the DBA, if the indemnity principle does not apply. Where it does apply, then (as explained above) D could receive a real windfall, in not having to pay any recoverable costs at all, if no DBA payment is due at all because the DBA itself is unenforceable. To reiterate, the DBA fee represents the ceiling on the amount of recoverable costs which D is liable to pay. As the Court of Appeal noted in *Hollins v Russell* [2003] EWCA Civ 718, [2003] 1 WLR 2487, [54], there may be a vested interest in D's challenging the enforceability of CFAs in a similar context: '*[n]or is it a question of the paying party being the only real policeman of CFAs, even though in practice, the receiving party is unlikely to have any incentive to take the point that the agreement between him and his solicitor is unenforceable. [but] there is nothing to suggest that the paying party is the gatekeeper chosen by Parliament to ensure compliance with s 58(1) [the provision governing lawful CFAs]*';

iv. whether the indemnity principle applies or is removed makes no difference to the amount of money which C receives — if it is disapplied, then it does not reduce the money being obtained by the client, C, whose interests are paramount in the matter. Take the example given in para 5i. above — if the indemnity principle did not apply in that scenario, then:

- C recovers £1M in damages;
- the agreed DBA fee is 50%;
- the DBA payment to which C's legal representative is entitled is £500,000;
- recoverable costs are assessed at £600,000;
- hence, absent the indemnity principle, C's legal representative is entitled to the full recoverable costs of £600,000 from D (hence, precluding any windfall to D);
- under the Ontario model, recoverable costs must be offset against the DBA fee, and hence, what C's legal representative has recovered by way of recoverable costs also represents his DBA fee; and
- that means that C himself obtains the full £1M of the damages recovered — precisely as occurred, where the indemnity principle applied.

Hence, disapplying the indemnity principle would not prejudice C.

6. The Working Group noted, however, that there were benefits in <u>retaining</u> the indemnity principle in DBA arrangements, particularly:

i. the application of the indemnity principle aligns DBAs with Conditional Fee Agreements, where the principle applies with equal vigour if the CFA is unenforceable. To cite the Court of Appeal in *Hollins v Russell* [2003] EWCA Civ 718 again, '*we must take it to be the policy of Parliament that the paying party should be protected by the indemnity principle in relation to the CFA entered into by the receiving party. In other words, that he should be entitled to object to paying costs which he has been ordered to pay if they are made payable by a conditional fee agreement which is not rendered enforceable by section 58(1)*' (at [53]). As noted in other sections of this Report, the clarity of funding jurisprudence may be enhanced if there was prudent coalescence between the features of the CFA regime and the DBA regime.

7. The Working Group also noted that, in the view of Lord Justice Jackson, the indemnity principle should be abrogated in English law: '*it is better that the rules should clearly set out what costs are recoverable in any situation, rather than rely upon a somewhat shadowy principle derived from case law [especially from British Waterways Board v Norman [1993] 26 HLR 232], which is subject to an ever growing number of exceptions*' (per [5.3.5]). Seven reasons were suggested for that recommendation — none of which related specifically to DBA arrangements, but all of which highlighted the controversies and inconsistencies that can arise from the application of the principle. However, to date, that recommendation has not been implemented. In *Reforming Civil Litigation Funding and Costs in England and Wales: Implementation of Lord Justice Jackson's Recommendations: The Government Response* (Mar 2011), there is no reference to abrogation of the indemnity principle in line with the Jackson proposal, and the Working Group understands that the Government remains unpersuaded that the principle requires reform.

8. As the Jackson *Final Report* notes (at [5.1.3]), the indemnity principle may have been a creature of common law, but it is now enshrined in statute (e.g., in s 60(3) of the Solicitors Act 1974). There is actually a provision 'on the statute books', which would permit the Civil Procedure Rule Committee to make rules '*for securing that the amount awarded to a party in respect of the costs to be paid by him to such representatives is not limited to what would have been payable by him to them if he had not been awarded costs*' (per s 31 of the Access to Justice Act 1999, which inserted this into s 51(2) of the Senior Courts Act 1981). The Court of Appeal noted, in *Hollins v Russell* [2003] EWCA Civ 718, [24], that s 51(2) had not been brought into force at that stage — and that remains the case today. Hence, the Working Group recognises that to abrogate the indemnity principle would require amendment to primary legislation, and a CPR rule change, all of which would take some initiative on the Government's part.

9. The Working Group considered whether one option would be to remove the indemnity principle for DBAs only, if a general abrogation of the principle were not likely, given the Government's disinclination to authorise a general reform and abrogate the indemnity principle 'across the board'. The view was that, if the principle were abrogated for DBAs, then it would be highly arguable that it would need to be abrogated for CFAs too. Whether the Government would be prepared to remove the indemnity principle for DBAs alone was, the Working Group recognised, a thorny policy issue.

10. If the success fee model is **not** implemented for DBA arrangements (per Section 22 above), then the removal of the indemnity principle would serve to avoid the windfalls to D, and to remove the difficult-to-

assess risks which the principle poses for C's legal representative. In that regard, the removal of the indemnity principle was one viable alternative to the success fee model.

11. If the success fee model is **not** implemented, and the indemnity principle is **not** removed either (either generally, or for DBAs in particular), then some Working Group members saw value in modifying the DBA fees, so that if the amount of costs that would be recoverable from D, apart from the DBA, was higher than 50% of damages for commercial cases (or 25% in personal injury cases), then the DBA fee should be increased to that higher amount.

To explain by means of an example: suppose that the damages recovered by C are £1,000,000; C's solicitor has entered into a 50% DBA with C; and recoverable costs awarded in the action are £600,000. This means that, applying the indemnity principle, C is only obliged to pay his solicitor £500,000 as the DBA fee (plus any expenses not within the cap and which are not recoverable from the opponent); and D obtains a windfall of £100,000, because the DBA fee of £500,000 represents the cap on those costs which C, as the receiving party, is entitled to recover from the paying party D. However, pursuant to the proposal suggested in this Discussion Point, the DBA fee could be modified, such that it was effectively the higher of either 50% of the damages recovered or the amount of costs recoverable from D but for the operation of the DBA and the indemnity principle. The DBA itself, entered into between C and his legal representative, would need to specify carefully that C was obliged to pay to that representative the higher of these amounts, to ensure that recovery of the entire £600,000 did not offend the indemnity principle.

This solution, if implemented, would remove the windfall problem; it would remove the injustice for C's legal representative in incurring costs which turned out to be irrecoverable; and it could be more politically palatable than removing the indemnity principle.

Recommendation

23.1 The Working Group's opinion on the issue of whether or not the indemnity principle should be abrogated for DBAs was divided (undoubtedly reflecting the opinion of the legal marketplace, as discussed in Chapter 5 of the Jackson report, *Review of Civil Litigation Costs*). The Working Group recommended, on balance, that the strength of arguments were in favour of abolishing the indemnity principle, insofar as it relates to DBAs. If it was not tenable, for Governmental policy, to remove

the principle for **all** civil litigation (as recommended by Lord Justice Jackson), then it may be possible to disapply the principle merely in the province of DBAs (whether it should also be abrogated for CFAs too would require a further policy decision to be taken by the Government). The application of the indemnity principle has the potential to wreak real injustice for C's legal representative, in the context of DBAs.

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24. RECOVERY UNDER A QUANTUM MERUIT

The issue

The commonly-held (and the existing Governmental policy) view is that, if a legal representative provides legal services under a DBA which is unenforceable, then not only will that legal representative be unable to recover any recoverable costs (due to the indemnity principle, per Section 23 above), but in addition, the legal representative will be unable to claim any judicially-awarded payment for a reasonable value for those legal services rendered to the client on a quantum meruit basis. Hence, an issue arises as to whether any statutorily-authorised quantum meruit should be considered, as a matter of legislative policy.

Discussion points

1. The Working Group understands that the current Governmental policy is that there is no prospect of a quantum meruit being statutorily-authorised in the 2015 DBA Regulations. Further, the Governmental opinion is that the judicial view will remain consistent with that — that a legal representative is unlikely to be able to claim payment successfully on a quantum meruit basis. For example, in the *Explanatory Memorandum* accompanying the 2013 DBA Regulations, it was stated that any failure to comply with the DBA Regulations would render the DBA void and unenforceable, and that '*in those circumstances, the representative will receive no payment*' (per para 7.5).

2. The Working Group notes that a claim in quantum meruit constitutes a restitutionary claim, for which the principles were set out by Lord Steyn in *Banque Financiere de la Cite v Parc (Battersea) Ltd* [1999] 1 AC 221 (HL) 227: (1) had D benefited or been enriched from the provision of services by C? (2) was the enrichment at the expense of C? (3) was the enrichment unjust? and (4) were there any defences?

3. However, the Working Group noted that, where a Conditional Fee Agreement is unenforceable, the firm judicial view is that, as a consequence, no quantum meruit recovery for the legal representative is permissible at law (per, e.g., *Westlaw Services Ltd v Buddy* [2010] EWCA Civ 929, [2010] 6 Costs LR 934,

[32]–[33], [65]). *In Birmingham CC v Rose Forde* [2009] EWHC 12 (QB) [206], Clarke J explained the reasons thus: '*to give effect to a claim for solicitor's costs, irrecoverable under [the CFA agreement], but re-labelled ... as a claim on a quantum meruit, would be contrary to public policy. If the prescribed conditions are not met, the agreement is, by statute unenforceable. Parliament must have intended that, in those circumstances, the solicitor could not recover his costs. There is no question of the solicitor being blameless. He knows, or should know, the rules but has failed to comply with them. To allow him to obtain the same (or a very similar) sum on a quantum meruit would defeat the statutory purpose. Such a claim would be available in every case where there was non-compliance with the rules, so that the statutory prohibition on enforcement would be illusory. Further, the client is not unjustly enriched nor should the court, as a matter of justice, impose an obligation of payment upon her, in circumstances in which statute has provided that the agreement under which she agreed to pay the courts should not be enforceable against her*.'

Hence, it is highly likely that a similar view would be applied, judicially, to a legal representative who had entered into an unenforceable DBA — he will not be granted a quantum meruit recovery in common law restitution.

4. The Working Group canvassed a number of reasons which could support the enactment of a statutorily-authorised quantum meruit award, in the event that a DBA was rendered unenforceable:

i. other professional service providers **do** have recourse to a quantum meruit, where their fee agreements are unenforceable (e.g., software and mathematician experts in *Matchbet Ltd v Openbet Retail Ltd* [2013] EWHC 3067 (Ch), and an architect in *Stephen Donald Architects Ltd v King* [2003] EWHC 1867 (TCC) — in both cases, the capacity of such professionals to recover reasonable fees on a quantum meruit was not judicially doubted);

ii. a very minor technical non-compliance with the 2015 DBA Regulations could mean that the legal representative recovered nothing at all;

iii. the prospect of no quantum meruit encourages the drafting of very light-handed Regulations, on matters where client protection should actually encourage greater detail (e.g., regarding

what information should be provided to the client before entry into the DBA; and what a DBA should contain);

iv. the lack of any quantum meruit may encourage clients to search for any areas of non-compliance by the legal representative, which means that the client does not have to pay for the legal services rendered;

v. by corollary, the lack of any quantum meruit may also encourage D to seek disclosure of a DBA entered into between C and his legal representative, and search for non-compliance areas too, given that the operation of the indemnity principle means that D will not be liable to pay any recoverable costs in that scenario (given that the amount paid by C to his legal representative will be zero). The prospect of D acting as 'policeman' of DBAs has been canvassed previously (in Section 23(5.iii) above).

5. However, the Working Group also noted the disadvantages and drawbacks, should a quantum meruit be statutorily-authorised where a DBA was rendered unenforceable:

i. the availability of a quantum meruit may encourage non-compliance (or, at least, poor compliance) by the legal representative with the terms of the 2015 DBA Regulations, at the expense of the client;

ii. to permit a quantum meruit would clearly be contrary to the established judicial practice governing CFAs, and may require a similar amendment to the governing legislation for CFAs, to ensure equivalence of statutory treatment;

iii. the legal profession is already highly-regulated, and in circumstances where legal representatives were officers of the court. In such circumstances, a differentiation between other professionals, and the legal profession, was justifiable; and

iv. even 'technical non-compliance' by a legal representative can jeopardise a client's protection and interests.

6. The Working Group also considered whether any alternatives to the 'lack of a quantum meruit' should be considered by the drafters of the 2015 DBA Regulations. The following were discussed:

i. a 'material breach' of the DBA which rendered the agreement unenforceable would entail no recovery on a quantum meruit, whereas a 'non-material' breach could permit restitutionary recovery. The Working Group acknowledged that the dividing line between these categories of breach would necessarily be difficult to define in some cases.

However, this approach draws some analogous support from the views of the Court of Appeal in *Hollins v Russell* [2003] EWCA Civ 718, where the court considered the enforceability of a CFA. Brooke LJ said (at [107]), '*[t]he key question ... is whether the conditions applicable to the CFA by virtue of Section 58 of the Courts and Legal Services Act 1990 Act have been sufficiently complied with in the light of their purposes. Costs Judges should accordingly ask themselves the following question: "Has the particular departure from a regulation pursuant to Section 58(3)(c) of the 1990 Act or a requirement in Section 58, either on its own or in conjunction with any other such departure in this case, had a materially adverse effect either upon the protection afforded to the client or upon the proper administration of justice?" If the answer is "yes", the conditions have not been satisfied. If the answer is "no" then the departure is immaterial and (assuming that there is no other reason to conclude otherwise) the conditions have been satisfied.*'

For example, in *Tranter v Hansons (Wordsley) Ltd* [2009] EWHC 90145 (Costs), there was a breach of Reg 4(2)(c) of the Conditional Fee Agreements Regulations 2000, because C's solicitors did not consider whether their client's risk of incurring liability for costs in respect of the proceedings to which the CFA related (an accident in which the client bus passenger was injured) was insured against, under the motor vehicle insurance policies customarily taken out by bus companies. Failing to make those enquiries constituted a 'material breach' of the CFA Regulations on their part, and the CFA was unenforceable. As a result of the indemnity principle, C's solicitors could not recover 'profit costs' from D, because C was under no obligation to pay those 'profit costs' to her own solicitors, the CFA being unenforceable.

Hence, the Working Group considered it possible that a *Hollins v Russell*-type approach would be adopted in the DBA context too, where the DBA was unenforceable due either to non-compliance with the DBA Regulations or with the overarching definition of a DBA in s 58AA of the Courts and Legal Services Act 1990. In the case of a 'non-material breach', the DBA would not be unenforceable, the indemnity principle would not be called into play, and hence, D would be liable to pay C's legal representative recoverable costs.

ii. as a further alternative, the legal representative whose DBA was unenforceable might be permitted to recover, using a lower costs scale. However, this would need to be specifically provided for in the 2015 DBA Regulations (and, if permitted for DBAs, then it would need to similarly be permitted for CFAs);

iii. the Working Group noted that, if hybrid DBAs were permitted (in all of their guises, without restriction), then it could at least permit the legal representative to retain the 'hourly rate' costs which were charged under that hybrid DBA.

Recommendation

24.1 Views as to whether or not C's legal representative ought to be able to recover on a quantum meruit, in the event that the DBA is unenforceable, were quite mixed among the Working Group. However, on balance, it concluded that no quantum meruit should be statutorily-authorised. The arguments disfavouring a quantum meruit outweighed those which favoured its statutory availability. Furthermore, the Working Group considered it possible that a *Hollins v Russell*-type solution might possibly be judicially developed (as it was for CFAs), where a legal representative's non-compliance with either the 2015 DBA Regulations or with s 58AA occurs, but that will be a matter for the courts.

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25. INDEPENDENT ADVICE ABOUT THE DBA

The issue

Despite strong recommendation by Lord Justice Jackson that independent advice should be obtained, prior to a client entering into a DBA with a legal representative, so as to provide an extra layer of 'regulation' of the DBA regime, that recommendation was not statutorily implemented. The question arises as to whether the benefits of such a recommendation would outweigh the costs, such that it should be implemented in the 2015 DBA Regulations.

Discussion points

1. In his report, *Review of Civil Litigation Costs* (Dec 2009), Lord Justice Jackson considered that a DBA should not be enforceable, unless the client had received independent advice about that DBA from a solicitor who had certified that he had advised the client about the terms of the DBA (per para 5.1(iii)). The question of who should pay for that independent advice was left open: '*[i]t would be a matter for discussion between solicitor and client*', and that if the solicitor did end up paying for it, because the client lacked the means to do so, that would not compromise the independence of the advice (per para 4.10).

2. Ultimately, this requirement for independent advice was not implemented by the drafters of the 2013 DBA Regulations. The Working Group understands that the key reason for that decision was that the drafters considered that the measure would add an additional cost to the DBA process which was not thought to be worthwhile in all the circumstances.

3. The Working Group took note of the fact that the *Code of Conduct for Litigation Funders* (Jan 2014) requires that independent advice be obtained before a Litigation Funding Agreement (LFA) is entered into. Clause 9.1 provides that, '*A Funder will take reasonable steps to ensure that the Funded Party shall have received independent advice on the terms of the LFA prior to its execution, which obligation shall be*

satisfied if the Funded Party confirms in writing to the Funder that the Funded Party has taken advice from the solicitor or barrister instructed in the dispute.'

4. There was no equivalent requirement for independent advice where DBAs were entered into for employment matters, under the 2010 DBA Regulations.

5. The Working Group identified a number of problems or drawbacks with any requirement that independent advice be compulsorily obtained:

i. conflicts of interest may conceivably arise, where another legal representative is introduced to the case, and who may take a view of the merits of (and an interest in) the dispute to which the DBA relates;

ii. the quality of the advice may be variable, even questionable, at times — and indeed, the complexity of the issues involved in DBAs, as reflected in the analysis contained in the Phase I study undertaken by this Working Group, bears testament to just how difficult it may be to provide the client with fulsome, yet digestible, advice about the DBA;

iii. undoubtedly, the requirement to pay an independent solicitor will create another cost, whether borne ultimately by the client or by the legal representative who is instructed in the dispute;

iv. the legal representative who is instructed in the dispute is already under a professional obligation, under the SRA's *Code of Conduct* (Version 14, revised 30 April 2015), to provide the client with the menu of funding options and to advise the client as to which funding option is appropriate to the needs and circumstances of the client (IB 1.19). Hence, it seems unnecessary to require another legal opinion to be furnished;

v. the confidentiality of the DBA agreement could be compromised by the requirement for independent advice, given that no model DBA agreement has yet been produced, and some legal representatives will have paid for bespoke DBA agreements to be drafted by counsel, which they will not be keen to distribute to potentially competitor firms; and

vi. it is always open to the client to obtain independent advice about the terms of the DBA if he wishes to.

Recommendation

25.1 On a costs–benefit analysis, the Working Group did not consider that any requirement for independent advice about the DBA should be incorporated in the 2015 DBA Regulations. A full explanation of the terms of the DBA is best addressed in other ways, particularly given the professional responsibilities resting upon a legal representative under the SRA's *Code of Conduct*.

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26. NOTIFICATION OF DBA FUNDING TO THE OPPOSING PARTY

The issue

To date, there has been no requirement that a DBA be notified to the opposing party (or to the court), under either of the incarnations of DBA Regulations enacted in 2010 (for employment matters) or in 2013 (for civil litigation generally). The question is whether there is any justification for imposing that requirement in the proposed 2015 DBA Regulations.

Discussion points

1. Insofar as other contingent forms of funding are concerned, there is no requirement that a Conditional Fee Agreement, or a Litigation Funding Agreement, be notified to the other side of the litigation. Where D applies for a security for costs order, then the presence of a Third Party Funder standing behind the litigation will become apparent, if the LFA provides that the Funder will meet any security for costs order made against the Funded Party (it being a requirement of the 2014 *Code of Conduct for Litigation Funding* that the LFA will state whether, and if so to what extent, the Funder will provide such security, per cl 10.3). Similarly, it is possible that DBA funding will become known to the other side, during the course of the litigation (e.g., when C submits a costs schedule or budget) — but without any requirement that it be disclosed.

2. The Working Group noted that, unlike in pre-LASPO days when D was liable for the success fee under a Conditional Fee Agreement, D is not liable now to pay for any outlays of that type. Similarly, the DBA fee will be paid to the legal representative from the damages recovered by C, and not by D. Hence, there is not the same need to notify D that C's case is being funded on a DBA basis, as D does not have the same vested interest in knowing of what funding arrangements C is utilising, as it did prior to 1 April 2013.

3. The notable exception to D's relative lack of interest or concern about the way in which C's case is being funded is where D may be entitled to pay less than the full recoverable costs, due to the application

of the indemnity principle (as discussed in Section 23 above). D may be interested to know on what basis C's legal representative is being paid for the legal services provided in the case, to ensure that D does not pay too much by way of recoverable costs (given that whatever that legal representative is paid by C under the DBA represents the ceiling of what recoverable costs can be obtained by D).

However, the most likely point in the litigation at which the DBA funding may become relevant to D is when recoverable costs are being quantified at the costs assessment stage, for C will only be able to claim the costs due under the DBA in its bill of costs. In that case, the Working Group did not consider that D should be entitled to know any sooner than that, as to whether it might have the benefit of a windfall arising from the indemnity principle.

4. The Working Group also considered whether there should be any requirement or benefit in the court being informed of the fact that DBA funding was being used in a case before it. However, this seemed unnecessary.

First, unitary litigation does not contain any certification regime that could require the court to certify financial adequacy of either party to bring or to defend the claim (contrast the certification which typically applies under opt-out collective actions regimes, and the corresponding recommendation contained in the EC's *Recommendation on Collective Actions* dated June 2013, in which Art 14 requires that '*[t]he claimant party should be required to declare to the court at the outset of the proceedings the origin of the funds that it is going to use to support the legal action*').

Secondly, if D brought a security for costs order against C, and for some reason C's legal representative had contracted under a DBA to provide that security (an unlikely, but not an impossible, scenario, as discussed in Section 28 below), then as with Funders, the existence of the DBA will inevitably come out into the open. However, it was not necessary to mandate that the DBA be disclosed for that reason.

Thirdly, the Working Group could not envisage a situation where the type of interim costs order made by the court would differ, depending upon whether or not the court knew that DBA funding was being employed.

Recommendation

26.1 In the Working Group's view, whilst the opposing party will likely 'end up knowing' of the fact that DBA funding is being used by the opposing party, it is unnecessary for that fact of funding to be notified to the opposing party (or to the court). That position would be entirely consistent with the non-disclosure of a CFA in the modern litigious environment. Hence, no such requirement should be incorporated in the 2015 DBA Regulations.

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27. TERMINATION OF THE DBA

The issue

The 2013 DBA Regulations do not contain any provisions regarding the grounds or manner of termination of the DBA, where the DBA is used for general civil litigation matters. Whatever provisions are contained in the 2013 DBA Regulations about termination (in Reg 8) pertain to DBAs for employment matters only. The issue for the Working Group was whether mandated grounds of termination should be specified in the proposed 2015 DBA Regulations as being the minimum grounds for termination contained in any DBA, or whether the grounds and manner of termination should be left entirely to negotiation between C (or D, if a defendant DBA is entered into) and his legal representative.

Discussion points

1. Re employment matters, the 2013 DBA Regulations are rather patchy and inconsistent, when the client's rights to terminate are contrasted with the legal representative's rights to terminate.

A legal representative can rely on only limited grounds of termination in an employment DBA, per Reg 8(4): '*The representative may not terminate the agreement and charge costs unless the client has behaved or is behaving unreasonably.*' However, there are no express provisions which similarly restrict the client's right to terminate on specified grounds, and hence, the client can, on the face of it, terminate an employment DBA for any reason.

2. Re the timing of the DBA's termination, there is nothing stipulated as to when a legal representative can terminate. However, for the client, Reg 8(3) provides that the client may not terminate the DBA: '*(a) after settlement has been agreed; or (b) within seven days before the start of the tribunal hearing.*'

The 2013 DBA Regulations contain provisions that: — the grounds and manner of termination stipulated in the 2013 Regulations are '*without prejudice*' to any rights that may accrue under the general

law of contract; and if it is the legal representative who terminates, then that lawyer cannot charge the client '*more than the representative's costs and expenses for the work undertaken in respect of the client's claim or proceedings.*'

3. However, the abovementioned provisions apply solely to employment matters, and to nothing else. The Working Group understands that the drafters' intention, in drafting the 2013 DBA Regulations in that way, was that it was thought that additional protection was necessary in employment matters, given that those cases could be conducted by non-legally qualified representatives who would not be subject to regulation by the SRA or other professional body.

By contrast, for solicitors and barristers who entered into a DBA, the grounds of termination (and the protection afforded to each side) were best left to 'professional best practice', given that they each were subject to regulation by their professional governing bodies, and any perceived misconduct by either barrister or solicitor in terminating the DBA inappropriately could be challenged through those bodies.

4. The Working Group also took note of the precedent which is provided by the *Code of Conduct for Litigation Funders* (Jan 2014), which restricts the Funder's right to terminate a Litigation Funding Agreement (LFA) entered into with a client. Clauses 11 and 12 of the *Code* provide as follows:

> *11. The LFA shall state whether (and if so how) the Funder, or Funder's Subsidiary, or Associated Entity, may … terminate the LFA in the event that the Funder, or Funder's Subsidiary, or Associated Entity:*
>
> *1. reasonably ceases to be satisfied about the merits of the dispute;*
> *2. reasonably believes that the dispute is no longer commercially viable; or*
> *3. reasonably believes that there has been a material breach of the LFA by the Funded Party.*
>
> *12. The LFA shall not establish a discretionary right for a Funder, or Funder's Subsidiary, or Associated Entity, to terminate a LFA, in the absence of the circumstances described [in cl 11 above].*

The Working Group took note of the fact that these clauses were duly included in the 2014 Code (and in its 2011 predecessor) for the protection of the Funded Client — but that Third Party Funders are in an entirely different circumstance from legal representatives, given that Funders are 'soft-regulated' by the Association of Litigation Funders, where they choose to be members of that Association (set out at <http://associationoflitigationfunders.com/documents/>).

5. The Working Group also noted that the relevant legislation governing Conditional Fee Agreements does **not** provide grounds for termination of a CFA. However, the Model Conditional Fee Agreement (CFA) (revised July 2014), produced by the Law Society of England and Wales, provides for how that CFA may be terminated by either side, per Sch 4, '*Law Society Conditions*'.

The client can '*end the agreement at any time*', and '*without reason*' (per Sch 3). Conversely, the legal representative can terminate the CFA if the client '*does not keep to his responsibilities*', or if the legal representative '*believes that the client is unlikely to win*', or if the client '*rejects the lawyer's opinion about making a settlement with the opponent*'.

Thus far, there has been no Model DBA produced by the Law Society (and the Working Group notes that whether or not the Law Society embarks on such a task is obviously for it to decide in due course).

6. The Working Group recognised that there were justifiable concerns, for both the client and for the legal representative, about the inappropriate termination of a DBA on either side.

For example, if a legal representative for C were to terminate the DBA because, say, a defence of illegality or contributory negligence looked far more likely after disclosure than it had before that stage, and the return to the legal representative consequently looked very poor (given that the '*payment*', or contingency fee, is based upon the '*sum recovered*' by C), then that would constitute a reasonable ground of termination by the legal representative. However, by contrast, if the legal representative considered that its overall exposure to DBA matters had become too great, and terminated its DBA with the client for that reason, then the grounds of termination would be unreasonable.

However, the concern about inappropriate termination could arise, equally, where C had been advised that its prospects of success at trial were excellent, and hence, terminated the DBA just prior to a judgment and an award of damages, thus precluding any liability to pay to the legal representative a percentage of those damages recovered.

7. Clearly, there are two approaches which have been adopted to date across the spectrum of contingency funding arrangements, as the above discussion demonstrates. One option (as applies to Third

Party Funders) is to restrict the grounds of termination to a limited few in the 2015 DBA Regulations, and to allow nothing wider than that. The other option (as applies to CFAs) is to leave the grounds of termination entirely to the negotiation of the legal representative and his client, without providing for that in the Regulations themselves (albeit that the termination of a CFA will, as mentioned above, also be subject to the applicable professional conduct rules).

8. The Working Group noted that the legal representative's ability to terminate the DBA will be restricted by its professional obligations. Under Indicative Behaviour 1.26 of the SRA's *Code of Conduct*, it is noted that '*ceasing to act for a client without good reason and without providing reasonable notice*' may tend to show that a solicitor has not achieved the outcomes required by the Code.

However, there is no similar overarching restriction on a client's right to terminate.

9. Regarding the risk that the client may terminate the DBA just prior to a successful claim at trial, the Working Group noted that the existing provisions in the 2013 DBA Regulations — stating that the client cannot terminate an employment DBA either after settlement, or within seven (7) days of the trial commencing — provided little comfort to a legal representative who had spent, possibly, years in preparing an action for trial. Indeed, the Working Group considered that Reg 8 of the 2013 DBA Regulations provided completely insufficient protection for a legal representative, were similar provisions to be applied to civil litigation generally. Termination of the DBA, eight days prior to trial, would leave the legal representative with the prospect of only recovering '*costs and expenses for the work undertaken in respect of the client's claim or proceedings*' (per Reg 8(2)) — a poor return indeed, if the legal representative obtains no return for the risk of funding the case on a DBA basis.

The Working Group noted that, under the model CFA revised by the Law Society (per Sch 4, '*Law Society Conditions*'), there is the prospect of a client having to pay a legal representative's '*basic charges, and our expenses and disbursements, including barristers' fees and success fees, if you go on to win your claim for damages*'. A similar protection could conceivably be incorporated within a DBA, ensuring that the legal representative was **not** left to his costs and expenses, if the DBA were terminated by the client close to the start of trial.

10. Finally, it was suggested by the Working Group that the possibility of a client's late termination of the DBA, just prior to the start of the trial, could be an argument in favour of the permission of a hybrid DBA. At least, under that hybrid DBA, the legal representative would be contractually entitled to a (discounted) hourly rate for services rendered. However, ultimately the Working Group considered that a clause in the DBA (somewhat similar to the drafting of the model CFA agreement prepared by the Law Society) would preserve the legal representative's right to *'basic charges, expenses and disbursements, including barristers' fees and the DBA payment*' upon termination by the client, provided that the effect of such a clause was clearly and adequately explained to the client at the outset.

Recommendation

27.1 On balance, the Working Group considered that grounds and manner of termination of a DBA, and the consequences of the termination on either side, was best left to negotiation between the legal representative and his client in the DBA itself, without providing for those in the 2015 DBA Regulations. The professional obligations to which each solicitor and barrister was subject should be sufficient protection for the client against inappropriate termination by that legal representative; and the ability to draft a suitable DBA was sufficient protection for the legal representative against inappropriate, or unfortunate, termination by the client.

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28. AWARDS OF COSTS AGAINST C'S LEGAL REPRESENTATIVES

The issue

Given that the legal representative who is funding an action on a DBA basis has a 'stake in the litigation', the question arises as to when (if at all) that legal representative would be liable for costs, and whether any statutory provision should be made for that scenario.

Discussion points

1. When acting under a lawful Conditional Fee Agreement, C's legal representative is generally entitled to an immunity from an adverse costs order (per the so-called *Hodgson* immunity, pursuant to *Hodgson v Imperial Tobacco Ltd* [1998] EWCA Civ 224, [1998] 1 WLR 1056. According to Lord Woolf MR (at 1065, 1067), '*[t]he existence of a CFA should make a legal advisor's position as a matter of law no worse, so far as being [personally] ordered to pay costs is concerned, than it would be if there was no CFA. This is unless, of course, the CFA is outside the statutory protection ... it must now be taken to be in the public interest, and should be recognised as such, for counsel and solicitors to act under a CFA. There are no grounds for treating the party who is or has been represented under a CFA differently from any other party. The same is true of their lawyers.*' This immunity is, of course, judicially-granted, it does not arise from the Civil Procedure Rules or from any other statutory source.

The Working Group understands that the Governmental view is that there is no necessity to provide statutorily for a similar immunity from adverse costs for the legal representative acting under a DBA, for it is likely that a court will extend a *Hodgson*-type immunity to the DBA context too.

2. However, it may be queried whether such an assumption would necessarily be correct. After all, a legal representative funding the litigation under a DBA is standing in a position somewhat akin to a Third Party Funder — funding the litigation for a stake in the outcome, represented by a 'cut' of the damages. And a Third Party Funder may be liable for a non-party costs order under the Supreme Court Act 1981, s 51(1)

and (3) (as inserted by the Courts and Legal Services Act 1990, s 4), given that it has a 'connection' with the proceedings in question.

For example, in *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655, [38], Lord Phillips MR remarked that, '*it [would be] unjust that a funder who purchases a stake in an action for a commercial motive should be protected from all liability for the costs of the opposing party if the funded party fails in the action.*' Of course, that case concerned a 'pure funder', i.e., one with no pre-existing interest in the subject matter of the litigation. However, Lord Phillips continued (at [44]), that, '*[w]hile we have confined our comments to professional funders, it does not follow that it will never be appropriate to order that those who, for motives other than profit, have contributed to the costs of unsuccessful litigation, should contribute to the successful party's costs on a similar basis.*' The sentiments of Lord Brown in *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] UKPC 39, [2004] 1 WLR 2807, [25] are also worth noting: '*[w]here, however, the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs. The non-party in these cases is not so much facilitating access to justice by the party funded as himself gaining access to justice for his own purposes*.' Arguably, a legal representative who is providing legal services, and so undertakes a case on a DBA, may fall within these sentiments.

On the other hand, the Working Group also noted that a solicitor acting under a DBA (as a lawful means of structuring his representation) may be viewed as being quite different from the position of a Funder whose involvement in the litigation is solely motivated by reasons of commercial investment.

In any event, it is not entirely clear that a Funder and a legal representative, both of whom are funding the litigation on a contingent basis, would (or should) be considered differently for this purpose, or that it can be assured with absolute confidence that the *Hodgson* immunity would be judicially 'carried over' to the DBA context.

3. However, and understandably, legal representatives would be loath to undertake any DBA funding at all, were it feasible that that legal representative could be liable for any adverse costs order, as a non-party, under s 51(1) and (3). Any uncertainty on this point will likely have a chilling effect on the take-up of DBA funding by law firms.

For that reason, some statutory clarification of the point (e.g., either permitting non-party costs orders against the legal representative, or prohibiting them in all cases except in circumstances where the *Hodgson* immunity would be lost), may be desirable in the 2015 DBA Regulations.

4. The Working Group anticipated that, if the legal representative engaged in any conduct under a DBA that might be considered to be champertous (such as taking an inappropriate degree of control of the litigation, and seeking to control its course), then a non-party costs order against that legal representative would be possible. However, the Working Group considered that such a scenario was extremely unlikely, and would be assessed on a case-by-case basis.

5. Further, under CPR 25.14(2)(b), a non-party security for costs order is possible against any party who '*had contributed or agreed to contribute to the claimant's costs in return for a share of any money or property which the claimant may recover in the proceedings, and is a person against whom a costs order may be made.*' In *Chilab v King's College London* [2012] EWCA Civ 1178, Hughes LJ clarified that the statutory precondition for such an award was that the third party must have '*contributed or agreed to contribute*' to C's costs, and that there should be an agreement for the third party to '*a share of any money or property which the claimant may recover in the proceedings*'. In *Chilab*, whilst the first limb may have been met, the second condition certainly was not (as there was no agreement by the non-party wife to share in any damages recovered by her husband, given that her contribution to her husband's costs of prosecuting the claim were made out of natural love and affection). However, in the case of a DBA entered into between a client and a legal representative, both limbs are likely to be satisfied.

Again, as with adverse costs, some statutory clarification of the point (either permitting non-party security for costs orders against the legal representative, or prohibiting them altogether), may be desirable in the 2015 DBA Regulations. Any potential liability for a security for costs order would have a chilling effect upon the take-up of DBAs by legal representatives.

6. Another query is whether a legal representative would be inclined, or indeed lawfully able, to contractually undertake to pay adverse costs, or to cover any security for costs order, if they were incurred, in return for a higher damages 'cut' of the sum ultimately recovered by C (albeit a cap that was within the statutory limits). Rarely, a law firm with a reasonably-sized 'war chest' may be in a position to do so.

Covering adverse costs and/or security for costs is customary for a Third Party Funder, and indeed, under the *Code of Conduct for Litigation Funding* (Jan 2014), the LFA is required to state whether (and if so, to what extent) the Funder is liable to the Funded Party to meet any adverse costs order, security for costs or 'other financial liability' (per cl 10). Presumably the DBA would also need to clearly stipulate that contractual obligation to cover adverse costs, security for costs, or any other expense.

There would appear to be nothing in the SRA's *Code of Conduct*, or at common law, to prevent the legal representative doing so. In *Sibthorpe v Southwark LBC* [2011] EWCA Civ 25, the legal representative's CFA provided that, if the client was unable to obtain an ATE policy to cover adverse costs, then '*we indemnify you against payment of your opponent's charges at the end of the case if you lose. This means that we will pay those charges.*' The question for the Court of Appeal was whether that indemnity was champertous. Lord Neuberger MR held that the ancient rule against champerty did not prevent a solicitor from agreeing to indemnify his client against any liability for adverse costs which that client might incur, if the claim against D was lost. That indemnity, in seeking to facilitate access to justice, was not champertous, mainly because modern authority '*strongly suggest that champerty should be curtailed not expanded, and, given that champerty is based on public policy, it is hard to see how arrangements such as the indemnity, at the very least in connection with litigation such as that in these cases, are against the public interest or undermine justice*' (at [51]). Furthermore, the inclusion of the indemnity in the CFA did not render the contract a contract of insurance — it remained, at all times, a contract for the provision of legal services (at [59]).

Recommendations

28.1 Given that some uncertainty may arise as to whether or not the *Hodgson* immunity will translate from the CFA context to the DBA context, some statutory clarification in the 2015 DBA Regulations (either mandating the legal representative's immunity from adverse costs unless exceptional circumstances applied, or permitting an adverse costs order in appropriate circumstances) may be warranted, so that legal representatives are not operating under any uncertainty in this regard.

28.2 There is no apparent reason why the legal representative may not contractually agree to cover any adverse costs order or security for costs order which is awarded in D's favour. Modern authorities tend to indicate that such an arrangement would not be champertous, or contrary to the SRA's *Code*

of Conduct. However, in order to avoid any satellite litigation about the point, the drafters of the 2015 DBA Regulations may wish to clarify the issue.

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29. THE *ARKIN* PRINCIPLE

The issue

Where a Third Party Funder is providing funding expenses in a case in which the legal representative is operating on a DBA, the question arises as to whether the *Arkin* principle would apply to the Funder, as it applies where the legal representative is acting on a Conditional Fee Agreement.

Discussion points

1. This section is directed to the scenario where a Third Party Funder is funding expenses only (because if a DBA is operative, then there will not be any legal fees for a Funder to directly fund to the client). This section is not aimed at the 'Funder's hybrid DBA' (discussed in Section 9 of the Report), where the Funder does not enter into an LFA directly with the client, but rather, enters into a funding agreement with the legal representative). In the Working Group's view, it is not entirely clear whether the Funder would be liable for adverse costs under a hybrid DBA (if the matter was left silent), given that the Funder is funding the legal representative's cash flow and not funding the action per se. However, this section is directed towards the scenario of where the Funder is funding the expenses in the litigation.

2. Under the so-called *Arkin* cap (named after *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655), the relevant legal representative was acting on a CFA, and a Third Party Funder provided the funds necessary to pay for the claimant's expert reports in the competition law litigation. The Court of Appeal held, in *Arkin*, that the Funder's liability to pay an adverse costs order is to be capped to the extent of the funding which the Funder provided to the Funded Party. It is always open to a Funder to contractually agree to cover a greater amount of adverse costs than the *Arkin* cap; but it is also open to a Funder not to contractually cover these at all, in which case the Funder is potentially liable to pay twice the amount of funding which it has provided to the Funded Party in order to advance the case, by virtue of the *Arkin* cap.

In *Excalibur Ventures LLC v Texas Keystone Inc (Rev 2)* [2014] EWHC 3436 (Comm), another CFA case, the court applied the *Arkin* cap, but noted that, '*[t]he position might be different if a funder had behaved dishonestly or improperly or if, as the Court put it in* Arkin*, "the funding agreement falls foul of the policy considerations which render an agreement champertous" e.g. if the funder has taken complete control over the litigation. In such a case, it may be that there should be no cap at all*' (at [72]).

Thus far, however, no case has addressed whether the *Arkin* cap would translate to the DBA context. To reiterate, in *Arkin* itself, the Funded Party's solicitors were operating on a CFA.

3. In his report, *Review of Civil Litigation Costs: Final Report* (Dec 2009), Sir Rupert Jackson recommended that, in order to protect a winning defendant, the *Arkin* cap should be statutorily overruled: '*either by rule change or by legislation, [a Funder] should be exposed to liability for adverse costs in respect of litigation which they fund. The extent of the Funder's liability should be a matter for the discretion of the judge in the individual case ,[but] should not be limited by the extent of its investment in the case*' (in para 11.4.7).

This recommendation has not as yet manifested in legislative reform — although if the drafters of the 2015 DBA Regulations were so minded, the reform of DBAs would present an opportunity to implement this, at least in that context. The Working Group noted that, if this recommendation of the Jackson Report is implemented, then that change would presumably need to be applied to CFA funded cases too.

4. However, the parity and fairness, as between a Funder under an LFA and a legal representative under a DBA, also arises for consideration. If a legal representative is not to be liable for adverse costs at all (an issue discussed in Section 28 above), then a Funder's liability under the *Arkin* cap stands in stark contrast, if both parties are in a position of funding the litigation at their own risk.

Recommendation

29.1 The *Arkin* cap is likely to be translated to the DBA context — unless the *Arkin* cap is statutorily overruled (as recommended in the Jackson Report). Nevertheless, any lack of parity between a legal representative who is funding the litigation under a DBA (who may bear no adverse costs order at all), and a Funder who is funding the litigation under an LFA (who may bear adverse costs to the

extent of the *Arkin* cap at least), may require some policy consideration by the drafters of the 2015 DBA Regulations.

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30. PERSONAL INJURY CLAIMS

The issue

The issue for consideration in this final section of the DBA project was whether DBAs should made available for personal injury litigation at all. If they should, then a related issue was whether any of the policy decisions which had governed the drafting of the 2013 DBA Regulations (e.g., limiting the heads of damage; and capping the DBA payment at 25%) would warrant review.

Discussion points

1. The decision to exclude future care costs and other future pecuniary damages from the heads of damages which are subject to the DBA fee was a policy decision derived from the Jackson report. In *Review of Civil Litigation Costs: Final Report*, it was recommended that: '*[i]n order to assist personal injury claimants in meeting the success fee out uof damages, I recommend that (i) the level of damages for pain, suffering and loss of amenity be increased by 10% across the board; and (ii) the amount of the success fee which lawyers may deduct be capped at 25% of damages, excluding damages referable to future case and for future losses*' (para 4.20). This recommendation was statutorily-implemented in its entirety.

2. Throughout the Working Group's discussions, a constant theme reiterated, from the claimant's perspective — that, without removing the restricted heads of damage to which the DBA fee could apply, **or** without raising the DBA cap from 25%, **or** both, the use of DBAs in the personal injury context was likely to be infeasible for low-value claims. In such claims, there may not be any, or any significant, component for future pecuniary losses and costs — but even so, the cap of 25% was infeasible, when including recoverable costs within that cap (per the Ontario model).

The Working Group understands that Governmental policy is that DBAs were never likely to be more popular than CFAs, at least in personal injury claims. That situation arises because, under a DBA, the legal representative's total payment is capped at 25% of the heads of damage which are statutorily-

specified; whereas under a CFA, the legal representative receives the recoverable costs, plus the success fee of up to 100% of costs (capped at 25% of specified damages). The costs payable to C's legal representative will be much lower on a DBA than on a CFA.

To illustrate via an example drafted by a member of the Working Group who is experienced in claimant personal injury litigation:

C recovers £10,000 in damages *in toto*.
Of that, £7,500 was PSLA and past loss, and £2,500 was damages for future losses.
Standard (base) costs on an hourly rate (including VAT) = £4,800
Disbursements = £1,000
Counsel's fee (including VAT) = £1,200

Under a CFA – the costs recoverable by C's legal representative were as follows:

	Base (recoverable) costs:	4,800
+	The success fee to which C's legal representative was entitled (i.e., 25% of the PSLA, and past losses):	1,875
+	Counsel's fee:	1,200
+	Disbursements:	1,000
TOTAL:		**£8,875**

This meant that C would receive (total damages recovered minus the success fee to which C's legal representative was entitled (i.e., £10,000 – £1,875): £8,125

Under a DBA – the costs recoverable by C's legal representative were as follows:

	DBA fee (25% of the PSLA, and past losses, and which fee must include counsel's fee, as that is within the DBA cap, as discussed in Section 1, Phase I, and VAT on solicitor's and counsel's fees):	1,875
+	Disbursements:	1,000
TOTAL:		**£2,875**

This meant that C's DBA fee of £1,875 was consumed entirely by the recoverable costs and counsel's fee. C would hence receive the total damages, and nothing would need to be deducted for the DBA fee, because the recoverable costs exceeded the DBA fee.
Hence, the total received by C would be: £10,000

3. For complex and high-value personal injury claims, using DBAs can be equally as problematical, in the view of some members of the Working Group. Frequently, the heads of damage for future losses will be significant, and the costs incurred to prove the recovery of those heads will be high. This means that, even for high-value personal injury claims, the size of the DBA fee could be considerably reduced to the point where the legal representative would find the claim infeasible.

4. Given the lack of use of DBAs in personal injury claims since the 2013 DBA Regulations were implemented, it has not been possible for the Working Group to assess the effect of these Regulations in that context, so as to assess whether there is any evidence of unmet need. No such evidence was provided to the Working Group during the course of its discussions.

5. The Working Group discussed **five** options for dealing with the interplay between DBAs and personal injury claims:

i. adding extra specified heads of damage to those which are presently (under the 2013 DBA Regulations) subject to the DBA fee; or to exclude future pecuniary losses from the damages to which the DBA can apply, but to permit all other damages to be subject to that DBA fee;

ii. amending the governing legislation to provide that the DBA fee should be calculated on the total damages recovered by C, with no excluded heads of damage;

iii. increasing the DBA cap from its present 25% to some higher cap;

iv. excluding personal injury claims from the revised 2015 DBA Regulations altogether;

v. either (i) moving to a 'success fee' model, or (ii) abolishing the indemnity principle for DBA claims, have been considered previously, in Sections 22 and 23 respectively, and will only be briefly mentioned in this context.

Dealing with each of these in turn:

6. ***Option i:*** In Section 17 of the Report, the Working Group considered whether further heads of damage should be added to the 2015 DBA Regulations by redrafting, so as to either (i) add specific heads of damage which have nothing to do with future care costs or future pecuniary damages (examples could include aggravated damages, exemplary damages, and the convention sum in 'wrongful conception' cases); or (ii) exclude future pecuniary losses from the damages to which the DBA can apply, but to permit all other damages to be subject to that DBA fee (which would cover those same heads of damage).

However, on balance, the Working Group recommended that to include extra heads of damage would cause a lack of symmetry between the calculation of the success fee under the Conditional Fee Agreements Order 2013 and the calculation of the DBA fee under the 2013 DBA Regulations. The wording of both sets of subsidiary legislation was almost identical, in that both ring-fenced future losses from costs recovery, so as to protect damages for claimants with serious injuries especially, to preclude their losing some of their future long-term care costs as part of the DBA fee. The Working Group concluded, in Phase I, that amending the DBA Regulations on this point would cause a lack of symmetry, or prompt a change to the longstanding CFA legislative framework which was unlikely to occur (unless the present Government has a significant change of policy view).

7. ***Option ii:*** Prior to the enactment of the 2013 DBA Regulations, several bodies supported the notion of calculating the DBA fee on the **total** damages recovered by C — the CJC Working Party on Damages-Based Agreements; the Association of Personal Injury Lawyers; and the Personal Injuries Bar Association. It was acknowledged by each of these bodies, at that time, that it was not realistic to expect C's legal representatives to act on a DBA, where the DBA fee (including counsel's fee, recoverable costs, and VAT) was limited to only 25% of past loss and PSLA (even if increased by 10%).

These bodies concluded that the DBA fee, net of those things, would be so low that no C's legal representative would choose to act under a DBA in personal injuries claims, rather than under a CFA.

8. The Working Group also noted that the comprehensive costs and funding review conducted by Sheriff Principal Taylor in Scotland concluded that the DBA fee should apply to **all** heads of damage, in personal injury claims.

In Chapter 9 of his report, *Review of Expenses and Funding of Civil Litigation in Scotland* (2013), Sheriff Taylor noted that, '*[at]t first sight, it may seem to be only right that the damages awarded for the future medical care of [C] should not be subject to any deduction under a damages based agreement, as was recommended by Jackson LJ. However, it is instructive to note that, in the series of implementation lectures given by Jackson LJ and others, Jackson LJ may be having second thoughts about this issue. ... Jackson LJ noted that PIBA and the Bar Council had subsequently sent to him "forceful submissions" that a deduction from all heads of damages should be permitted. They had changed their view. One can only speculate what Jackson LJ might have recommended, had PIBA and others held the view which they now advance to the effect that a deduction from all heads of damages should be permitted. It is reasonable to infer that the recommendation might well have been different*' (at [93]). Ultimately, Sheriff Taylor concluded that, '*[o]n balance, I prefer the position adopted by the Civil Justice Council Working Party. Accordingly, I recommend that future loss should not be excluded from the ambit of a damages based agreement. This has the considerable advantage of simplicity. Protection for [C] should be achieved by other means*' (at [103]).

One of those 'protections' was that, where C was funded by a DBA, and the agreed damages contained a head of damage of future loss of >£1 million, then C's legal representative '*will require to obtain either the approval of the court, or a report from an independent actuary certifying that it is in the best interests of [C] that damages should be paid by way of a lump sum, as opposed to periodical payments, before [C's] solicitor will be entitled to make a deduction from the future loss element of an award of damages in order to satisfy the success fee*' (at [111]).

9. ***Option iii:*** Whether the cap of 25% for personal injury claims should be raised in the context of where large commercial insurers or large public bodies defend personal injury claims brought on a portfolio basis, and where that defendant enters into a DBA with its legal representative, was considered in Section 6 of the Report.

However, in this Phase II of the DBA project, the Working Group considered whether the cap of 25% for claimant personal injury claims should be revised, so as to make DBAs more feasible in that context. There is no doubt that the present drafting maximises the protection of C's damages, but if DBAs are unusable as a result, what is the point of any such protection? One option is to increase the DBA cap to 35%, which is the cap applicable to employment claims. For those cases which have a high costs-to-damages ratio,

the availability of an extra 10% recovery (whether on the restricted heads of damages, or on all damages) could render those low value claims more viable.

The Working Group concluded that, to increase the DBA cap for personal injury claims was solely a matter of Governmental policy.

10. ***Option iv:*** The Working Group pondered whether it would be worthwhile to excise personal injury claims from revised 2015 DBA Regulations altogether, given the complexities that are already present in DBAs (as illustrated in the Phase I study). However, on balance, it considered that to retain all possible forms of funding for personal injury claims was the preferable option, especially in this relatively early phase of DBA implementation.

11. ***Option v:*** Either (i) moving to a 'success fee' model, or (ii) abolishing the indemnity principle for DBA claims, have been considered previously in Phase I, in Sections 22 and 23 respectively. Some members of the Working Group considered that implementing either of these options would be preferable to increasing the deductions from the claimant's damages (say, raising the DBA cap to 30–35%), given the potential injustice for injured claimants in losing a greater percentage of their damages than is currently the case.

Recommendations

30.1 In respect of personal injury litigation, the Working Group recommended that it was not feasible to add extra specified heads of damage to those which are presently (under the 2013 DBA Regulations) subject to the DBA fee; or to exclude future pecuniary losses from the damages to which the DBA can apply, but to permit all other damages to be subject to that DBA fee.

30.2 The Working Group was divided on the other options by which to handle the interplay between the DBA Regulations and personal injury litigation. Some members considered that, to amend the governing legislation to provide that the DBA fee should be calculated on the total damages recovered by C, with no excluded heads of damage; or to increase the DBA cap from its present 25% to some higher level, was solely a matter of Governmental policy — but that some renewed consideration ought to be given to each of those possibilities, if the use of DBAs for personal injuries remained unviable. On the contrary, some other members considered that the better method of

improving the application of the DBA Regulations to personal injury claims was either to remove the indemnity principle or to convert from the Ontario model to the Success Fee model.

30.3 Ultimately, the Working Group, by unanimous view, did **not** consider that excluding personal injury claims from the revised 2015 DBA Regulations altogether would be desirable, this early in the implementation of DBA reform. All funding options should be preserved, at this stage.

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APPENDICES

APPENDIX 1

The Working Group was asked to make recommendations to the Government on a draft version of the Damages-Based Agreements Regulations 2015 (hereafter, 'the 2015 DBA Regulations') with which it was provided by the Ministry of Justice. This appendix sets out some of the redrafting suggestions made by the Working Group, during the course of Phase I of the project (each is discussed in further detail in the relevant sections of Phase I).

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Citation, commencement, interpretation and application

1(1) These Regulations may be cited as the Damages-Based Agreements Regulations 2014 and come into force on XX XXXX 2014, or, if made on or after that date, the day after the date on which they are made.

(2) In these Regulations—

"the Act" means the Courts and Legal Services Act 1990;
"claim" includes a counter-claim and, accordingly, "claimant" includes a counter-claimant and "defendant" includes a defendant to a counter-claim,
"claim for personal injuries" has the same meaning as in Rule 2.3 of the Civil Procedure Rules 1998;
"client" means the person who has instructed the representative to provide advocacy services or litigation services (within section 119 of the Act) and is liable to make a payment for those services;
~~"costs" means the total of the representative's time reasonably spent, in respect of the claim or proceedings, multiplied by the reasonable hourly rate of remuneration of the representative;~~
"employment matter" means a matter that is, or could become, the subject of proceedings before an employment tribunal;

"~~expenses~~" "disbursements" means disbursements incurred by the representative, including ~~the expense of obtaining an expert's report~~ any fees paid or payable to an expert, ~~but excluding counsel's fees~~ and counsel's fees;

"financial benefit"—

(a) includes money or money's worth; and

(b) excludes any sum in respect of the client's legal fees, costs or disbursements which has been paid or is payable by another party to the claim or proceeding.

~~(i) any costs (including fixed costs);~~

~~(ii) any sum in respect of disbursements incurred by the representative in respect of counsel's fees; and~~

~~(iii) any expenses incurred by the representative,~~

~~which have been paid or are payable by another party to the claim or proceedings.~~

"representative" means the person providing the advocacy services or litigation services to which the damages-based agreement relates;

"representative's payment"—

(a) means that part of any financial benefit obtained in respect of the claim or proceedings that the client agrees to pay the representative; and

(b) excludes ~~expenses~~ disbursements.

(3) Subject to paragraph (4), these Regulations apply to all damages-based agreements entered into on or after the date on which these Regulations come into force.

(4) These Regulations do not apply to—

(a) any damages-based agreement to which section 57 of the Solicitors Act 1974 (non-contentious business agreements between solicitor and client) applies; or

(b) an employment matter; or

(c) an agreement ("a litigation funding agreement") under which—

(i) a person ("the funder") agrees to fund (in whole or in part) the provision of advocacy or litigation services (by someone other than the funder) to another person ("the litigant"); and

(ii) the litigant agrees to pay a sum to the funder in specified circumstances.

Revocation of the 2013 Regulations and transitional provision

2(1) Subject to paragraph (2), the Damages-Based Agreements Regulations 2013 ("the 2013 Regulations"), in so far as they apply to claims or proceedings other than an employment matter, are revoked.

(2) The 2013 Regulations, in so far as they apply to claims or proceedings other than an employment matter, shall continue to have effect in respect of any damages-based agreement to which those regulations applied and which was entered into before the date on which these Regulations come into force.

Requirements in respect of a damages-based agreement

3(1) The requirements for the purposes of section 58AA(4)(c) (agreement must comply with such other requirements as to its terms and conditions as are prescribed) of the Act are prescribed by this regulation.

(2) The terms and conditions of the damages-based agreement must specify—

(a) the claim or proceedings or parts of them to which the agreement relates;

(b) the circumstances in which the representative's payment and disbursements, ~~expenses and costs~~, or part of them, are payable, including—

(i) where relevant, whether the amount of the representative's payment depends upon the stage at which the claim or proceedings are concluded; and

(ii) a description of the anticipated financial benefit to which the agreement relates;

(c) the reason for setting the amount of the representative's payment at the level or levels agreed;

~~(d) that in respect of the claim or proceedings or parts of them to which the agreement relates—~~

~~(i) the client will not be required to pay an amount other than that prescribed in regulation 4(1);~~

~~(ii) the payment of the representative's costs, expenses and, where relevant, disbursements in respect of counsel's fees—~~

(aa) will not be the subject of another agreement between the client and the representative; and

(bb) will not be payable if an agreement or order is not made in favour of the client or if the client does not receive any of the financial benefit stated in the agreement; and

(iii) the terms and conditions in subparagraph (d)(i) and (ii)(aa) are without prejudice to any terms and conditions in respect of the termination of the agreement.

The representative's payment

4(1) In respect of any claim or proceedings or parts of them to which these Regulations apply, a damages-based agreement must not require an amount to be paid by the client other than—

(a) the representative's payment, and

(b) any disbursements,

net of any sum in respect of the client's legal fees, costs or disbursements which has been paid or is payable by another party to the claim or proceedings.

(a) the representative's payment, net of—

(i) any costs (including fixed costs under Part 45 of the Civil Procedure Rules 1998); and

(ii) where relevant, any sum in respect of disbursements incurred by the representative in respect of counsel's fees,

that have been paid or are payable by another party to the claim or proceedings by agreement or order; and

(b) any expenses incurred by the representative, net of any amount which has been paid or is payable by another party to the claim or proceedings by agreement or order.

(2) In a claim for personal injuries where the client receives damages in respect of those injuries—

(a) the only sums received by the client from which the representative's payment shall be payable shall exclude damages for future pecuniary loss,

are—

(i) general damages for pain, suffering and loss of amenity; and

~~(ii) damages for pecuniary loss other than future pecuniary loss,~~

net of any sums recoverable by the Compensation Recovery Unit of the Department for Work and Pensions; and

(b) subject to paragraph (5), a damages-based agreement must not provide for a representative's payment above an amount which, including VAT, is equal to 25% of the sums in paragraph 2(a) ~~combined sums in paragraph (2)(a)(i) and (ii)~~ which are received by the client in satisfaction of the agreement or order.

(3) Subject to paragraph (5), if in a claim for personal injuries a financial benefit is obtained by the defendant, a damages-based agreement must not provide for a representative's payment above an amount which, including VAT, is equal to ~~25%~~ 50% of the financial benefit obtained by the client.

(4) Subject to paragraph (5), in any other claim or proceedings to which these regulations applies, a damages-based agreement must not provide for a representative's payment above an amount which, including VAT, is equal to 50% of the value of the financial benefit obtained by the client.

(5) The amounts prescribed in paragraphs (2)(b), (3) and (4) shall only apply to claims or proceedings at first instance.

Agreements between a representative and an additional representative

5. Regulations 3 and 4 do not apply to a damages-based agreement between a representative and an additional representative.

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APPENDIX 2

The Courts and Legal Services Act 1990 (as amended by LASPO 2012)

58AA Damages-based agreements

(1) A damages-based agreement which satisfies the conditions in subsection (4) is not unenforceable by reason only of its being a damages-based agreement.

(2) But (subject to subsection(9)) a damages-based agreement which does not satisfy those conditions is unenforceable.

(3) For the purposes of this section—

a damages-based agreement is an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services which provides that—

(i) the recipient is to make a payment to the person providing the services if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided, and

(ii) the amount of that payment is to be determined by reference to the amount of the financial benefit obtained;

(4) The agreement—

(a) must be in writing;

(aa) must not relate to proceedings which by virtue of section 58A(1) and (2) cannot be the subject of an enforceable conditional fee agreement or to proceedings of a description prescribed by the Lord Chancellor;

(b) if regulations so provide must not provide for a payment above a prescribed amount or for a payment above an amount calculated in a prescribed manner;

(c) must comply with such other requirements as to its terms and conditions as are prescribed; and

(d) must be made only after the person providing services under the agreement has complied with such requirements (if any) as may be prescribed as to the provision of information.

(5) Regulations under subsection (4) are to be made by the Lord Chancellor and may make different provision in relation to different descriptions of agreements.

(6) Before making regulations under subsection (4) the Lord Chancellor must consult—

(a) the designated judges,

(b) the General Council of the Bar,

(c) the Law Society, and

(d) such other bodies as the Lord Chancellor considers appropriate.

(6A) Rules of court may make provision with respect to the assessment of costs in proceedings where a party in whose favour a costs order is made has entered into a damages-based agreement in connection with the proceedings.

(7) In this section—

"payment" includes a transfer of assets and any other transfer of money's worth (and the reference in subsection (4)(b) to a payment above a prescribed amount, or above an amount calculated in a prescribed manner, is to be construed accordingly);

"claims management services" has the same meaning as in Part 2 of the Compensation Act 2006 (see section 4(2) of that Act).

(7A) In this section (and in the definitions of "advocacy services" and "litigation services" as they apply for the purposes of this section) "proceedings" includes any sort of proceedings for resolving disputes (and not just proceedings in a court), whether commenced or contemplated.

(8) Nothing in this section applies to an agreement entered into before the coming into force of the first regulations made under subsection (4).

(9) Where section 57 of the Solicitors Act 1974 (non-contentious business agreements between solicitor and client) applies to a damages-based agreement other than one relating to an employment matter, subsections (1) and (2) of this section do not make it unenforceable.

(10) For the purposes of subsection (9) a damages-based agreement relates to an employment matter if the matter in relation to which the services are provided is a matter that is, or could become, the subject of proceedings before an employment tribunal.

(11) Subsection (1) is subject to section 47C(8) of the Competition Act 1998.

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APPENDIX 3

LIST OF THE WORKING GROUP'S RECOMMENDATIONS (PHASE I)

1.1 The Working Group recommends that, for reasons of practicality and workability, the drafting of the 2015 DBA Regulations should be amended, such that counsel's fees should **always** be treated as an '*expense*', i.e., outside the cap. (However, this should be read subject to recommendation 14.1, so that solicitor + counsel's DBAs do not exceed the statutorily-set DBA cap.)

1.2 The concern about the drafting of Reg 3(2)(d)(ii)(bb) prompted the Working Group to recommend that Reg 3(2)(d)(ii)(bb) be deleted from the Regulations.

2.1 The Working Group recommends that, in Reg 1(2), the example of the 'expert's fees' should be retained. However, it would be desirable for the wording to change, as follows (shown in italics):

'disbursements' means disbursements incurred by the representative, including *any fees paid or payable to an expert*, and counsel's fees.

2.2 The Working Group recommends that the term, 'expenses', should be deleted from the 2015 DBA Regulations, wherever occurring, and replaced with the term, 'disbursements', which has a widely accepted meaning.

2.3 An exhaustive list of expenses/disbursements was not warranted in the 2015 DBA Regulations.

3.1 The Working Group considered that, on balance, VAT should remain within the cap, where that VAT was not recoverable by the client. Otherwise, where VAT is recoverable, then VAT should be excluded from the cap. Appropriate adjustments to the drafting should reflect this, such that the situation regarding VAT was rendered absolutely certain, from the client's perspective.

3.2 The Working Group also noted that the phrase, 'representative's payment' is used in Reg 4(2)(b) and in Reg 4(3), but the word 'payment' is used in Reg 4(4). It recommends the use of 'representative's payment', in Reg 4(4), given that the phrase has a defined meaning in Reg 1(2).

4.1 The definition of '*financial benefit*' in Reg 1(2) should be redrafted to read as follows (with the redrafting in bold):

'financial benefit' –

(a) *includes money or money's worth; and*

(b) *excludes* ***any sum in respect of the client's legal fees, costs or disbursements which has been paid or is payable by another party to the claim or proceeding.***

4.2 The definition of 'costs' in Reg 1(2) should be omitted from the 2015 DBA Regulations.

5.1 The Working Group recommends that the term, '*financial benefit*', and in particular, its sub-definition of '*money's worth*', means that it should be open for a legal representative and his client to define the trigger for payment in the DBA itself where the case is won (i.e., whether securing a judgment, or securing cash, or other '*money's worth*'). Although the concept of '*financial benefit*' is usefully defined in Reg 1(2), the question of what amounts to a 'financial benefit' in the particular case in question should be left to the definition of the parties in the DBA itself on a case-by-case basis — so that the client and the solicitor themselves can agree that the solicitor's fee can be payable, whether or not the client actually recovers any damages. Given that s 58AA of the CLSA 1990 refers to a '*specified financial benefit*', the client and his solicitor should legitimately be able to specify precisely what constitutes a *'financial benefit*' as a matter of contractual negotiation.

5.2 Although Reg 3(2)(d)(ii)(aa) was supposed to be directed to precluding hybrid DBAs, it is conceivable that it unintentionally covers the use of two DBAs by C — one for a claim and one for a counterclaim. It is recommended elsewhere in this Report (recommendation 15.1) that this provision will need redrafting, if the obligation contained within it is to be rendered a substantive obligation, and not merely something that should be contained in the DBA as a term. Its drafting will need reconsideration for the reason identified in this section of the Report too.

5.3 If the recommendation in 5.1 is not adopted, the Working Group also recommends that the drafting of the 2015 DBA Regulations should make provision for what should happen, where a counter-claim or set-off is brought against C. As illustrated in discussion point 2, if C's DBA fee is to be calculated strictly on what C *actually recovers* in the litigation in terms of money, where a counter-claim applies, then that will yield a different calculation from what the answer would be if one calculated C's DBA fee as a percentage of the '*financial benefit obtained*' by C. Also, the use by defendants of DBAs brings into sharp relief the same dilemma, i.e., that the amount recovered by D (by virtue of a successful counter-claim) may be entirely different from a measure of the '*financial benefit obtained*' (if a defence is successful). Clarification of these issues in the drafting will be necessary, for otherwise, litigation inter partes is very likely, to seek judicial clarification of what is, precisely, the '*financial benefit*' obtained, where counterclaims and defences are won and lost.

6.1 The Working Group recommends that the present drafting of Reg 3(2)(b)(ii) be reconsidered, to ensure that it could be met by the setting out of a methodology by which D's '*financial benefit*' is to be calculated (given that such a methodology may be the only feasible way of describing the anticipated financial benefit, at the outset of the litigation). This is especially so, when there are at least three different reference points for assessing what amount of damages was actually saved by D's successful (either entire or partial) defence of the litigation.

6.2 Further, the Working Group recommended that Reg 4(3) be amended, to substitute a 50% cap for the presently-stated 25% cap. (Alternatively, the Working Group recommended that Reg 4(3) could be deleted, in which case a DBA used by D to defend personal injury claims would be encompassed within the catch-all provision of Reg 4(4), which itself provides for a DBA cap of 50%.) If Reg 4(3) is retained, then clarifying that the damages to which the DBA fee applied did not pertain only to the heads of damage that are stipulated in Reg 4(2)(a) may also be helpful.

6.3 On balance (this point was subject to differing views amongst members), the Working Group recommended that Reg 4(3) re retained explicitly (but redrafted according to the recommendation in 6.2), rather than permitting a DBA used by D to defend personal injury claims to merely be encompassed within the catch-all provision of Reg 4(4), which itself provides for a DBA cap of 50%.

Retaining Reg 4(3) would emphasise that the cap of 50% for a defendant's DBA, in respect of a claim for personal injuries, was intentional and not inadvertent.

7.1 No amendments to Regs 1(3) or 2(2) were necessary. Both provisions are clear and workable.

8.1 Although the prospect of sequential Hybrid DBAs is allowed by the drafting of Reg 3(2)(a) of the 2015 DBA Regulations, the Working Group considered that the Regulations should define what a 'part' of the claim or proceedings could entail (e.g., whether the 'part' can be a reference to a time period, or a legal task, or an issue, or a claim or counterclaim).

8.2 The Working Group also recommends that the 2015 DBA Regulations need to specify clearly whether the solicitor can retain the monies recoverable under the non-DBA funding agreement, and to which the DBA fee should be added (if recoverable); or whether it is intended that the monies recoverable under the non-DBA funding agreement should be offset (i.e., included within) the DBA fee, once paid. The answer to this conundrum is not provided on the face of the 2015 DBA Regulations as presently drafted, but will have great ramifications upon the utility of sequential Hybrid DBA agreements.

8.3 Finally, as a corollary of recommendation 8.2 above, the Working Group considers that the 2015 DBA Regulations should clarify (to whatever extent that may not be clear already, from the drafting associated with 8.2 above) that, in respect of that part of the claim or proceedings to which the DBA does not relate, the payment of the solicitor's costs and expenses, are payable, regardless of whether or not the client receives any of the '*financial benefit*' stated in the DBA (i.e., that the converse of what is presently in Reg 3(2)(d)(ii)(bb) should be spelt out).

9.1 As currently drafted, the 2015 DBA Regulations, in particular, Reg 3(2)(d)(ii)(aa), are not infringed by the Funders' Hybrid DBAs to which the Working Group had regard. (The Working Group cannot comment upon other Hybrid DBAs which may be offered by other Funders on the market.)

9.2 If a law firm enters into a DBA with client C, and wishes to be paid for its WIP during the course of the conduct of the litigation, there is nothing on the face of these Regulations to prevent that law

firm from entering into a second agreement for payment of that WIP — provided that the second agreement is entered into with a Funder, or some other party, *but not with the client C*.

10.1 The Working Group recommended that Reg 1(4) of the 2015 DBA Regulations should be amended as follows (with the amendment shown in bold):

These Regulations do not apply to—
(a) any damages-based agreement to which section 57 of the Solicitors Act 1974 (non-contentious business agreements between solicitor and client) applies;
(b) an employment matter; ***or***
(c) an agreement ("a litigation funding agreement") under which—
(i) a person ("the funder") agrees to fund (in whole or in part) the provision of advocacy or litigation services (by someone other than the funder) to another person ("the litigant"); and
(ii) the litigant agrees to pay a sum to the funder in specified circumstances.

11.1 The Working Group was divided in opinion, as to whether the provisions for a sliding scale of DBA fees (whether determined on the stage at which the proceedings are concluded, or on the basis of the level of financial benefit obtained by C) — *viz*, Reg 3(2)(b)(i) and Reg 3(2)(c) — should be retained in the 2015 DBA Regulations, as being requisite terms of the DBA. Essentially, this division of opinion reflected the reality that, the more mandated content for the DBA which the Regulations specified, the more likely that a legal representative would omit to include some technical matter, thereby rendering the DBA unenforceable (a disastrous consequence, with no *quantum meruit* available to that legal representative). According to the opposing view, however, that mandated content for the DBA was a price worth paying, to promote full disclosure to the client of the sliding scale payments for which he will be liable.

11.2 In Reg 3(2)(b), opening words, the phrase, 'and costs' should be deleted, as those are not payable under the DBA itself.

11.3 The Working Group also recommends that the 2015 DBA Regulations should clarify (preferably by a suitable amendment of Reg 3(2)(c)), that the second type of sliding scale DBA fee identified by

the Working Group, i.e., where the percentage of recovery depends upon the level of damages recovery obtained by C, is permitted.

12.1 Given the concern about the lack of consumer protection which may arise, if DBAs entered into pre-suit (whether by a solicitor or by any other entity), in respect of 'non-contentious business', are not regulated, the Working Group recommends that the Government may wish to reconsider the necessary amendments to primary legislation to permit DBAs to be regulated, pre-commencement of litigation. However, the full implications of this recommendation for all types of business would need to be considered carefully.

12.2 The interplay, as between legal representatives who use the one DBA for pre- and post-issue stages of a proceedings (which would be covered by the 2015 DBA Regulations) and CMCs which provide pre-litigation services (which would not be covered by those Regulations), should also be given further consideration, when considering the application of DBAs pre-suit.

12.3 The arguable proposition that CMCs may be drawn into the ambit of the 2015 DBA Regulations, by virtue of the wide definitions of the '*advocacy services*' and '*litigation services*' which appear in the definition of the '*representative*' in Reg 1(2) — notwithstanding that any reference to '*claims management services*' was removed from that definition in the 2015 DBA Regulations — gives rise to the prospect of satellite litigation on this issue (particularly if C objects to the fee agreement entered into with the CMC). The Working Group recommends that the situation regarding the application of the 2015 DBA Regulations to CMCs, be further investigated and then clarified, either within the Regulations or in relevant primary legislation.

13.1 The Working Group recommended that the philosophy underpinning Reg 4(5) of the 2015 DBA Regulations, i.e., that the statutorily-imposed caps for personal injury and for commercial matters should only apply to first instance decisions, and should not necessarily apply to any appeals conducted from those first instance decisions, should be retained.

13.2(a) A majority of the Working Group recommended that it was **not** necessary for the Regulations to require a 'first instance DBA' to specify whether or not it governed any appeal in the claim or proceedings. Rather, C and his legal representative should be free to negotiate different funding

terms for any appeal, whether under a DBA or under some other form of funding (such as a CFA, or an hourly rate basis) — and this negotiation could be conducted either upfront, or at any time during the course of the claim or proceedings (including proximate to the appeal itself). Hence, the DBA for the first instance proceedings could validly remain silent on the issue of any appeal. This was a desirable course, given that: (i) the many and varied circumstances surrounding an appeal were too numerous to be discussed with any surety at the outset of the claim or proceeding; (ii) the legal representative could only feasibly measure the risk of conducting an appeal (and, hence, an appropriate DBA cap for an appeal) when confronted with the prospect of that appeal (e.g., depending upon whether key questions of fact had gone against C at first instance); and (iii) to increase the specified content of the DBA (by specifying what should happen, if an appeal were involved) would ensure yet another point of potential non-compliance with the 2015 DBA Regulations, and increase the prospect of yet another 'costs war'.

13.2(b) A minority of the Working Group considered that the 2015 DBA Regulations should specify that the DBA for first instance proceedings must state explicitly (for the benefit of client C), whether or not an appeal is covered under the DBA. The minority considered that C should know (at a point at which the bargaining position of C and his legal representative were relatively equal) whether or not the DBA caps also covered any appeal in the claim or proceedings, or if so, what those caps should be. According to the minority, disputes about the quantum of the DBA fee (especially if the damages on appeal were reduced) were likely to lead to satellite litigation, if the application of the DBA to appeals was not insisted upon at the outset.

13.3 The Working Group recommends that Reg 4(5) should clarify *the timing* at which the legal representative was entitled to the DBA fee. That is, as a matter of policy, the 2015 DBA Regulations need to clarify whether the DBA fee can be calculated according to the financial benefit obtained at first instance, or whether the DBA fee will always be conditional on the outcome of an appeal (if any).

14.1 Where C enters into separate DBAs with a representative, and with an additional representative directly, then it should be clarified, via a new Reg 5(2), that the DBA fees recovered by the representative and the additional representative should not, in combination, exceed the DBA caps specified in Reg 4.

14.2 On balance, the Working Group did **not** consider that uncertainty would arise as to who is the '*additional representative*', and hence, a clarification of that phrase, either in the definitions section in Reg 1(2) or in Reg 5, was not considered to be necessary.

15.1 The Working Group recommends that Reg 3(2)(d)(i)–(ii) should be deleted, and any substantive obligations contained therein redrafted accordingly.

15.2 It further recommends that the presumed intent underlying Reg 3(2)(d)(iii) — that in the event of termination of the DBA, the legal representative was entitled to payment under some separate agreement between the client and the representative other than the DBA — should be retained in the 2015 DBA Regulations, but with alternative drafting.

16.1 The Working Group had no recommendation to make on this issue, given that a costs order could probably be sought and ordered, but the costs could not be summarily assessed, if C were conducting the litigation on a DBA-funded basis. Hence, the prospect of C's having to pay back some of those costs to D, in order to comply with the indemnity principle, is not going to arise, in practice.

17.1 On balance, the Working Group concluded that the 2015 DBA Regulations, in seeking to give effect to the Government's policy position that future pecuniary losses cannot be subject to the DBA, should **not** be redrafted. That is, Reg 4(2)(a) should **not** be recast so as to explicitly provide that the '*sums received by the client from which the representative's payment shall be payable*' should be permitted to include all other damages recoverable by that client (i.e., exemplary damages, conventional sums, etc), other than future pecuniary losses. Symmetry between the method of calculating the DBA fee, and the long-standing method of calculating the success fee under a conditional fee agreement, was considered to be desirable.

17.2 Any further recommendations, regarding the interaction between the 2015 DBA Regulations and personal injury claims, are contained in Section 30 of the Report.

18.1 The Working Group considers that the 2015 DBA Regulations should **not** deal with this issue, e.g., by specifying that a breakdown of the heads of damage should be compulsorily undertaken in any

global settlement sum. Rather, the division among heads of damages in a global settlement sum should be dealt with as between C and his solicitor, given that: (1) it was inherent in the solicitor's professional duties that he must act in the interests of C at all times (failing which sanctions may ensue); and (2) failing agreement between C and his solicitor as to an appropriate breakdown, other forms of dispute resolution (e.g., a referral about an appropriate breakdown of the settlement sum to an independent third party) were already countenanced in professional organisations' guidelines or model letters. Hence, it was unnecessary for the 2015 DBA Regulations to deal with the issue.

19.1 The new definition of '*financial benefit*' in Reg 1(2), to '*include money or money's worth*', was sufficient to cover a myriad of circumstances where what is recovered by C is some tangible or intangible asset, other than money. However, the Working Group recommends that the 2015 DBA Regulations should specify that, where the '*financial benefit*' to which the DBA relates is represented by '*money's worth*', then the DBA must stipulate **either** the value (as a monetary figure) of that '*financial benefit*', **or** alternatively, some formula by which the value of that '*financial benefit*' is to be quantified (if necessary, by reference to a valuation undertaken by an independent third party). In the latter case, the date of valuation of the '*financial benefit*' should also be stipulated in the DBA.

19.2 The requirement, in Reg 3(2)(b)(ii), that the DBA must specify '*a description of the anticipated financial benefit to which the agreement relates*', was not considered to be specific enough to cover the suggested mandated content of the DBA noted in recommendation 19.1, above. Nevertheless, the Working Group considered that, on balance, Reg 3(2)(b)(ii) should be retained in the 2015 DBA Regulations, as it provided information to the client, as to whether the recovery was damages, something else which represents '*money's worth*', or a combination of the two.

19.3 In Reg 4(4), the Working Group recommends that it should be redrafted, to state as follows: ' ... a damages-based agreement must not provide for a *representative's* payment which, including VAT, is equal to 50% of the *value of the* financial benefit obtained by the client'.

20.1 Reg 4(1) of the 2015 DBA Regulations could be simplified (amended as shown in bold), to provide that:

In respect of any claim or proceedings or parts of them to which these Regulations apply, a damage-based agreement must not require an amount to be paid by the client other than—

(a) the representative's payment, and

(b) any disbursements,

net of any sum in respect of the client's legal fees, costs or disbursements which has been paid or is payable by another party to the claim or proceedings.

20.2 The 2015 DBA Regulations should be clarified, to provide that the representative and the client may agree that, regardless of whether or not C receives any financial benefit in the claim or proceedings, the client is obliged to pay the disbursements incurred in the conduct of that claim or proceedings.

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APPENDIX 4

LIST OF THE WORKING GROUP'S RECOMMENDATIONS (PHASE II)

21.1 The Working Group was divided on the question of concurrent hybrid DBAs, with some members considering that there was no good reason to prohibit their use, and that market freedom should prevail; whilst other members considered that the case in favour of concurrent hybrid DBAs had not been proven. It concluded that it was a policy decision which was ultimately one for the Government. However, the Government should be encouraged to evaluate the arguments in favour of concurrent hybrid DBAs, even in the absence of any cadre of cases which have tested the arguments (given the nervousness of the legal marketplace on this issue).

22.1 Most members of the Working Group favoured the implementation of the Success Fee model, in preference to the Ontario model, given the several advantages which the Success Fee model entails. Certainly, whether the Ontario model or the Success Fee model should be implemented, by which to govern recoverable costs, should warrant a review of Governmental policy, given the advantages which accrue with the Success Fee model. However, if the Success Fee model were to be implemented, the statutorily-set ceilings may require reducing.

23.1 The Working Group's opinion on the issue of whether or not the indemnity principle should be abrogated for DBAs was divided (undoubtedly reflecting the opinion of the legal marketplace, as discussed in Chapter 5 of the Jackson report, *Review of Civil Litigation Costs*). The Working Group recommended, on balance, that the strength of arguments were in favour of abolishing the indemnity principle, insofar as it relates to DBAs. If it was not tenable, for Governmental policy, to remove the principle for **all** civil litigation (as recommended by Lord Justice Jackson), then it may be possible to disapply the principle merely in the province of DBAs (whether it should also be abrogated for CFAs too would require a further policy decision to be taken by the Government). The application of the indemnity principle has the potential to wreak real injustice for C's legal representative, in the context of DBAs.

24.1 Views as to whether or not C's legal representative ought to be able to recover on a quantum meruit, in the event that the DBA is unenforceable, were quite mixed among the Working Group. However, on balance, it concluded that no quantum meruit should be statutorily-authorised. The arguments disfavouring a quantum meruit outweighed those which favoured its statutory availability. Furthermore, the Working Group considered it possible that a *Hollins v Russell*-type solution might possibly be judicially developed (as it was for CFAs), where a legal representative's non-compliance with either the 2015 DBA Regulations or with s 58AA occurs, but that will be a matter for the courts.

25.1 On a costs–benefit analysis, the Working Group did not consider that any requirement for independent advice about the DBA should be incorporated in the 2015 DBA Regulations. A full explanation of the terms of the DBA is best addressed in other ways, particularly given the professional responsibilities resting upon a legal representative under the SRA's *Code of Conduct*.

26.1 In the Working Group's view, whilst the opposing party will likely 'end up knowing' of the fact that DBA funding is being used by the opposing party, it is unnecessary for that fact of funding to be notified to the opposing party (or to the court). That position would be entirely consistent with the non-disclosure of a CFA in the modern litigious environment. Hence, no such requirement should be incorporated in the 2015 DBA Regulations.

27.1 On balance, the Working Group considered that grounds and manner of termination of a DBA, and the consequences of the termination on either side, was best left to negotiation between the legal representative and his client in the DBA itself, without providing for those in the 2015 DBA Regulations. The professional obligations to which each solicitor and barrister was subject should be sufficient protection for the client against inappropriate termination by that legal representative; and the ability to draft a suitable DBA was sufficient protection for the legal representative against inappropriate, or unfortunate, termination by the client.

28.1 Given that some uncertainty may arise as to whether or not the *Hodgson* immunity will translate from the CFA context to the DBA context, some statutory clarification in the 2015 DBA Regulations (either mandating the legal representative's immunity from adverse costs unless exceptional

circumstances applied, or permitting an adverse costs order in appropriate circumstances) may be warranted, so that legal representatives are not operating under any uncertainty in this regard.

28.2 There is no apparent reason why the legal representative may not contractually agree to cover any adverse costs order or security for costs order which is awarded in D's favour. Modern authorities tend to indicate that such an arrangement would not be champertous, or contrary to the SRA's *Code of Conduct*. However, in order to avoid any satellite litigation about the point, the drafters of the 2015 DBA Regulations may wish to clarify the issue.

29.1 The *Arkin* cap is likely to be translated to the DBA context — unless the *Arkin* cap is statutorily overruled (as recommended in the Jackson Report). Nevertheless, any lack of parity between a legal representative who is funding the litigation under a DBA (who may bear no adverse costs order at all), and a Funder who is funding the litigation under an LFA (who may bear adverse costs to the extent of the *Arkin* cap at least), may require some policy consideration by the drafters of the 2015 DBA Regulations.

30.1 In respect of personal injury litigation, the Working Group recommended that it was not feasible to add extra specified heads of damage to those which are presently (under the 2013 DBA Regulations) subject to the DBA fee; or to exclude future pecuniary losses from the damages to which the DBA can apply, but to permit all other damages to be subject to that DBA fee.

30.2 The Working Group was divided on the other options by which to handle the interplay between the DBA Regulations and personal injury litigation. Some members considered that, to amend the governing legislation to provide that the DBA fee should be calculated on the total damages recovered by C, with no excluded heads of damage; or to increase the DBA cap from its present 25% to some higher level, was solely a matter of Governmental policy — but that some renewed consideration ought to be given to each of those possibilities, if the use of DBAs for personal injuries remained unviable. On the contrary, some other members considered that the better method of improving the application of the DBA Regulations to personal injury claims was either to remove the indemnity principle or to convert from the Ontario model to the Success Fee model.

30.3 Ultimately, the Working Group, by unanimous view, did **not** consider that excluding personal injury claims from the revised 2015 DBA Regulations altogether would be desirable, this early in the implementation of DBA reform. All funding options should be preserved, at this stage.