

EXECUTIVE SUMMARY

INTRODUCTION:

1. The Working Party on Conditional and Contingency Fees (“the Working Party”) was established to study the conditional and contingency fees systems in the Commonwealth jurisdictions, especially England and Wales and to make recommendations to the Council as to the feasibility of implementing either of the systems in Hong Kong or such other option as may be appropriate.
2. This Executive Summary outlines the experience of conditional fees in England and Wales; the experience of contingency fees in USA and Canada; and the advantages and disadvantages of the two systems. As part of a consultation exercise, a Master List of pros and cons of conditional and contingency fees has been posted on the Law Society website, Members’ Zone. Members are invited to express their views by completing the third column in the Master List. The second column represents the different views of members of the Working Party.
3. The advantages and disadvantages on the conditional and contingency fees in the Executive Summary and the Master List are based on the systems in England and Wales and in Canada respectively.
4. The consultation process will be followed by a members’ forum after which the Working Party will draw its conclusions and recommendations.

CONDITIONAL FEES:

Definition

5. A standard conditional fee agreement (“CFA”) is a ‘no win no fee’ agreement where a lawyer is paid a pre-agreed percentage uplift on the normal fees charged subject to the review of the Courts if a claim is successful. Most common law jurisdictions exclude CFA in criminal and matrimonial matters.

The Experience in England and Wales

6. In England and Wales, CFA was introduced in 1995 in personal injury, insolvency proceedings and proceedings brought before the European Commission and European Court of Human Rights. In 1998 the scheme was extended to all kinds of cases except family and criminal cases. In the 1995 scheme only the lawyer’s basic charges could be recovered from the losing paying party. The success fee and after the event (“ATE”) insurance premium were paid by the client from his own money most usually from his damages. In April 2000 the scheme was amended to introduce the recovery of success fee and insurance premium from the paying party at the same time as legal aid was withdrawn from

most personal injury claims. This measure was introduced so that people did not have their damages reduced by lawyers' fees and to place them in the same position as they would have been if they were legally aided.

7. In order to be enforceable, CFAs:
 - (a) must be in writing and signed by both the client and the legal representative
 - (b) must not relate to proceedings in which CFAs are prohibited
 - (c) if CFA provides for a success fee, it must state the percentage increase
 - (d) must not exceed the statutory maximum
 - (e) must state the circumstances in which payment by the client is due and the methods by which payment is to be calculated
 - (f) must specify the reasons why success fee is set at a stated level, identify how much of the percentage uplift relates to the postponement of payment i.e. the financing element by the lawyer, which is not recoverable against the other party

8. The regulations also prescribe that certain information must be given to the client before a CFA is signed. These include the circumstances under which the client is liable to pay the costs of his own lawyer and the other side, circumstances in which he may seek an assessment of his own lawyer's fees, whether the lawyer considers the client should be insured for potential liability for costs; what methods are available for financing the costs of litigation and what method is appropriate.

9. Variations of CFAs are permitted under the regulations:
 - (a) 'No win, no fee' agreement with success fee if win
 - (b) 'No win, reduced fee' agreement with success fee if win
 - (c) Normal fees if win and nothing if lose
 - (d) Normal fees if win and reduced fee if lose

10. Other variations include CFAs with break clauses; CFAs which allow for deduction of disbursements from interim damages awarded or the lawyer may simply ask the client to pay privately for initial investigation, including expert reports and provision which specifies that CFAs only come into play after the institution of proceedings.

* Applies to both conditional and contingency fees

11. The maximum success fee allowed is 100% of normal fees. A two-stage success fee has been suggested in recent cases which allows for a high uplift to be substantially discounted in the event of settlement at an early stage.
12. ATE insurance is available but not compulsory. ATE insurance is legal expenses insurance which indemnifies any liabilities against costs. An ATE policy covers a specific legal action for which a lawyer has already been instructed. The policy lasts as long as the legal action. There are mainly 3 types of ATE insurance:
 - (a) CFA cover which provides cover for the opponent's costs and disbursements and the client's own disbursements
 - (b) Both sides' costs cover which indemnifies all costs of both parties to litigation
 - (c) Hybrid cover which is a mixture of 12(a) and 12(b)
13. In addition to CFAs entered into between solicitors and their clients, it is permissible for solicitors and barristers to enter into a conditional fee arrangement.
14. The experience in England and Wales shows that CFA has not been met with enthusiasm by the insurance companies which now have to pay the "additional liabilities". The introduction of CFA has created a spiral of satellite litigation in which parties compel each other to disclose CFAs, challenge their enforceability and the recoverability of success fees and ATE insurance premiums and whether their amounts are reasonable. Such litigation has caused delays in thousands of assessments and only serves to highlight the uncertainty and difficulties which beset the regime.
15. In addition, the continuance of the indemnity principle has created problems. The principle provides that a successful party may only claim those costs from the losing paying party for which the successful party is actually liable to his own lawyer. That being the case, the paying party may exploit any technical defect in the CFA to argue it is unenforceable, the client has no obligation to pay his lawyer and therefore neither does the losing paying party have any liability to pay the costs. Challenges made in this way have caused terrible uncertainty to law firms.
16. Other difficulties have arisen regarding ATE insurance. There are tensions between after the event providers and liability insurance providers as to an appropriate level of premium. It is claimed by ATE providers exclusively providing ATE insurance tactics have been used by liability insurance providers to undermine the market by underpricing.
17. In spite of all these problems, CFAs have been embraced in England in the fields of personal injury and defamation. 100% success fees have been awarded in a

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number of personal injury and defamation cases. The impression is that CFA offers a much wider access to justice.

18. In view of the difficulties with CFAs, the Law Society of England and Wales is looking into other costs systems, including contingency fees and fixed costs. As recent as 2 June 2003, new rules have been implemented which enable lawyers to enter into CFAs to abrogate the indemnity principle. The government is proposing a consultation exercise which aims to simplify the whole CFA regime.

Advantages and Disadvantages of CFAs

19. From the public's point of view, the advantages of a conditional fee arrangement include:
- (a) The system increases access to justice to those, particularly the middle class, who cannot afford to pay their own lawyers and who are not eligible for legal aid.*
 - (b) It enables lawyers to offer more flexible and competitive price options to consumers.*
 - (c) Risks of litigation are passed to lawyers who are better equipped to assess such risks than clients.*
 - (d) Lawyers can spread the risks and costs across a wider range of clients by adjusting success fees and by insurance.*
 - (e) It encourages greater level of commitment by the lawyers as the success fee encourages them to pursue claims; maximize potential recovery; and complete the claim as soon as possible.*
 - (f) Claimant enters a cost-free and risk-free zone with no financial incentive to accept reasonable offers or payments into court. This is an advantage in so far as the public are the winners in any given litigation. Arguably, insurers will be the losers although increased costs may ultimately be shifted to the public through increased insurance premiums.*
 - (g) Better defence for defendants opposing a weak claim by a wealthy and oppressive plaintiff.*
 - (h) Increased burden in losing a claim may encourage the defendants to pursue earlier settlement where the prospects of a successful defence are less likely.

* Applies to both conditional and contingency fees

20. The disadvantages from the public's point of view include:
- (a) The introduction of CFAs may lead to abolition of legal aid for the majority of claims. Moving people away from legal aid will only work for those able to afford the insurance costs - i.e. the middle class. The present legal aid category will still be needed.*
 - (b) CFAs may not be equally successful in areas of litigation other than personal injury work.*
 - (c) It is not clear that there will be insurance cover available either after the event or before. It is likely to be at a prohibitive rate given the level of Hong Kong legal fees.
 - (d) The cost of litigation overall will increase due to the cost of insurance and the increased fee upon success.
 - (e) Plaintiffs with strong merits would easily find a lawyer to take up their case. Lawyers would be less willing to take on less meritorious cases.*
 - (f) Motivation is wrong - a change to the legal regime is being made for fiscal reasons: to save money on the legal aid budget.*
 - (g) CFAs lead to an escalation in costs.
 - (h) Unsuccessful defendants will be burdened by the additional cost penalty of paying a successful claimant's uplifted fees.
 - (i) Anecdotal material in England suggests that defendants are litigating more aggressively.
 - (j) In any event, disputes over the level of success fee and ATE insurance premium seem inevitable as they depend on subjective factors on the plaintiff's side which the defendants are in no position to know or challenge until the same are litigated.
 - (k) In England and Wales, the system has led to a new industry of satellite litigation about the recoverability and the size of success fee and ATE insurance premium and to the creation of a new class of person, the costs negotiator.
 - (l) There is nothing to stop defendants from acting under CFAs. If defendant CFAs become common, ATE companies in England & Wales say they are likely to respond by putting up premium or by imposing higher success criteria on cases which they are willing to underwrite.

* Applies to both conditional and contingency fees

- (m) As success fee is a percentage of costs, this forms the incentive to increase base costs.
 - (n) Increased insurance costs will ultimately be shifted to the public through increased insurance premiums.
21. From a lawyer's point of view, the advantages of a conditional fee arrangement include:
- (a) A new body of litigants may arise being persons without legal aid who presently cannot afford litigation. *
 - (b) The system gives lawyers flexibility in fee arrangements. *
 - (c) Lawyers have common financial interest with client in succeeding in the client's claim. *
 - (d) It encourages lawyers to take on meritorious cases which would otherwise be pro bono work. *
 - (e) It gives lawyers a more direct and personal involvement in the case. *
 - (f) The success fee encourages lawyers to pursue claims. *
 - (g) The success fee encourages lawyers to maximize potential recovery. *
 - (h) The success fee encourages lawyers to complete the claims as soon as possible. *
 - (i) Firms which have the strength to win a competitive bidding war with large insurance companies about the size of success fees and the cost of disbursements can attract a large body of claim work. *
 - (j) It enables lawyers to compete with debt collectors. *
22. The disadvantages from the lawyer's point of view include:
- (a) The system increases the financial burden of lawyers, especially the small firms:
 - (i) Much complication will be introduced into the current litigation system for very uncertain benefits. The preparation of CFAs, the need to explain the details to clients and potential clients, disputes arising from CFAs, the need to negotiate corresponding agreements with experts and counsel all add significantly to the administrative costs of lawyers. *

* Applies to both conditional and contingency fees

- (ii) Lawyers cannot be paid during the course of litigation. No interim billing for fees and (possibly) disbursements. *
- (iii) Lawyers become bankers for their clients by paying court fees, expert fees and other expenses. *
- (iv) Lawyers bear the risks of litigation for their clients. *
- (v) The system may lead to abolition of legal aid for the majority of claims. Firms relying on legal aid work will run at a loss in the first years if it is replaced by conditional fees due to the need for funding on-going litigation. *
- (vi) The risk of abuse of the system by insurance companies and other bulk suppliers of work who do not need the lawyer to fund their litigation. *

Lawyers undertaking CFAs must manage their finance much more carefully. Those succeeding in doing so will incur additional management costs. Those failing may go bankrupt. *

- (b) Introduction of CFAs has not done away with the no-win-no-pay recovery agents. They still prosper in England.*
- (c) Any agreement the lawyer makes with the client for a success fee uplift may be reviewed by the Courts at the end of the case. *
- (d) There is no certainty what percentage of success fee will be allowed. Added to the uncertainty is what will be allowed as taxed costs. *
- (e) CFAs may encourage litigants and lawyers to bring nuisance or unmeritorious claims with the aim of coercing the defendants into a settlement and to earn a conditional fee. *
- (f) Direct interest in the outcome of litigation may encourage lawyers to indulge in undesirable practices to enhance the chance of success of litigation. On the other hand, with a strong claim, the lawyer is motivated by success fees to fight on through the trial rather than to settle for a reasonable sum which would satisfy the client. *
- (g) Lawyers start to judge whether a step in an action is appropriate or not by the fee economics rather than the legal issues or client's interests. *
- (h) To the extent CFAs will result in increase in litigation, lawyers behaving less ethically and nuisance claims being pursued (and perhaps encouraged) by lawyers, they may adversely affect the image of the profession. *

* Applies to both conditional and contingency fees

- (i) Availability of conditional fees encourages pushy advertising and ambulance chasing. *
- (j) Creation of expectation on the part of litigants that litigation will be conducted on a no-win-no-fee basis with guaranteed recovery of success fees and ATE insurance premiums may present practical problems in the conduct of litigation by lawyers. *
- (k) Problems will arise if the lawyer and the client hold different views on settlement. *
- (l) As the lawyers will only be paid if the case is successful, "success" must be defined at the beginning of the case. This may be difficult in anything other than simple litigation as the chances of success may not be readily ascertainable at the beginning of a case. *
- (m) Lawyers would be placed in a difficult position if counsel did not also agree to work on a conditional basis as the client would not expect to pay counsel's fees on an interim basis. *
- (n) CFAs lead to escalation in costs. Claimant enters a cost-free and risk-free zone with no financial incentive to accept reasonable offers or payments into court.

CONTINGENCY FEES:

Definition

23. A standard contingency fee agreement is a 'no win no fee' agreement where the lawyer is paid a percentage of the amount recovered if the claim is successful. In the United States, the loser pays principle does not apply and each party bears its own costs. In Canada, costs are awarded against the losing party.

The US Experience

24. Contingency fees have been implemented in USA since the mid-19th century. Typically, contingent fees have been used in personal injury, debt collection, mass tort cases, e.g. tobacco and asbestos cases, consumer class actions, security fraud and antitrust cases. Contingent fees are prohibited in criminal defence, domestic relations and legislative work.
25. Contingent fee agreements are widely used by American trial lawyers. It has been said that contingent fees do encourage the bringing of cases which would not otherwise be brought and such cases have had a significant impact on the development of American law.

* Applies to both conditional and contingency fees

The Canadian Experience

26. All Canadian provinces have enacted legislation to permit contingency fee arrangements; in Manitoba, as early as 1890, and in Ontario in late 2002. Some jurisdictions prohibit contingency fees in family law, cases where the legally disabled are involved, distribution of estates and criminal cases. The experience with contingency fees varies from state to state in Canada.

Advantages and Disadvantages of Contingency Fees

27. The same advantages and disadvantages of conditional fees apply to contingency fees under the Canadian system with the exceptions of paragraphs 19(h), 20(c), 20(d), 20(g) to 20(n) and 22(n) set out above. Those advantages and disadvantages shared by conditional and contingency fees are set out in this Executive Summary in the paragraphs marked with an asterisk.
28. In addition, the following advantages apply to contingency fees:
- (a) Costs are reduced because unlike conditional fees, the losing party does not have to pay the success fee or ATE insurance premium.
 - (b) It encourages lawyers to be more efficient as the lawyers' reward depends on the outcome of litigation, not on the number of hourly rates charged.
 - (c) Cases should settle earlier.
29. The following additional disadvantage applies to contingency fees:
- (a) The plaintiffs will receive lower amounts of net recoveries (after payment of contingent fees), unless the damages awarded by the courts are inflated to ensure adequate net recoveries by meritorious claimants.

* Applies to both conditional and contingency fees