CONTINGENCY AND CONDITIONAL FEES

THE STRUCTURES, THE POSITION IN HONG KONG, AND THE COMPARISON WITH ENGLAND

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11TH MARCH, 2004

1. Control of Solicitors' Remuneration in Hong Kong

1.1 Fees chargeable by solicitors in Hong Kong are subject to a number of controls. These come principally from Part VI of the Legal Practitioners Ordinance (Cap.159) ("the "LPO"), and the Hong Kong Solicitors' Guide to Professional Conduct, particularly Chapter 4. Other regulations in the Solicitors Practice Rules, or in relation to legal aid, may also apply.

1.2 The permissible arrangements for solicitors' costs differ between contentious and non-contentious business. There are also differences between what is permissible in civil contentious matters as against criminal contentious matters.

1.3 The principle controls relevant to this topic are as follows: Section 56 of the LPO sets out the basic arrangement for remuneration of solicitors in non-contentious business. It is possible, by an agreement in writing, signed by the client, to agree to remuneration on any basis, subject to other overriding principles, such as solicitors must not overcharge their clients. This means that for non-contentious business, remuneration may be by way of fixed amount, commission or percentage, or time spent at hourly rates, or otherwise. Provided the agreement is in writing and signed, it may be sued on like any other contract (again subject to other overriding rules explained below). In particular, the client has the right to seek a taxation of the solicitors' costs.

1.5 Sections 58-60 set out provisions in relation to remuneration of solicitors for contentious business. Section 58 permits the making of a written agreement with a client as to remuneration for contentious business either on the basis of a gross sum or by salary - hourly rates. This may be at a greater or lesser rate than the solicitors would ordinarily charge. The flexibility as to remuneration in non-contentious business (contained in section 56) is, for contentious business, glaringly absent, and this forms the focus of the debate on conditional

fees. Suing on a contentious business fee agreement is also not as straightforward as in the case of non-contentious agreement: section 60 provides that no action may be brought upon a section 58 agreement, although the court has the power to review, enforce or set aside the agreement on the application of the solicitors. The court may enforce the costs agreement if it is of the opinion that it is in all respects fair and reasonable. By section 62, this court review supersedes the normal provision for taxation.

1.6 These sections deal with situations where there is an agreement with the respect to costs. Where there is no agreement at all, or any agreement does not fulfil the requirements for being in writing, then a solicitor will be entitled to reasonable remuneration. What is reasonable will depend on each case, and what if anything was discussed orally or in writing between the solicitor and the client. Nevertheless, the specific provisions above relating to costs agreements will not apply.

1.7 Sections 64-71 set out general provisions regarding remuneration of solicitors, of which most importantly section 64(1)(b) provides for invalidity of any agreement by which a solicitor is retained or employed to prosecute any action, suit or other contentious proceeding [which] stipulates for payment only in the event of success in their action suit or proceeding.

1.8 Chapter 4 of the Hong Kong Solicitors' Guide to Professional Conduct deals with fees, covering such general matters as information to clients about costs, interim bills, payments on account and the form and contents of bills. Nevertheless, relevant to the present discussion are the following:

1.9 4.12 contains the overriding principle that a solicitor must not overcharge his client. This is also covered by the Solicitors' Costs Rules, rule 5. If an agreement is made between the

solicitor and client which is found to be wholly unreasonable, disciplinary action may be taken against the solicitor.

1.10 4.14 contains provisions in relation to a Hong Kong solicitor assuming liability for overseas lawyers instructed by him personally. Nevertheless, a consequence of this is that a Hong Kong solicitor may agree the basis of fees of an overseas lawyer to be on a contingent basis, even in circumstances where that would be unlawful in Hong Kong, provided it is permitted within the jurisdiction of that overseas lawyer. For example, therefore, a Hong Kong solicitor may engage US lawyers to pursue litigation in the US on any fee arrangement permissible by US principles.

1.11 Finally, principle 4.16 extends the general ban on contingency fee arrangements:

A solicitor may not enter into a contingency fee arrangement for acting in contentious proceedings: see section 64 of the Legal Practitioners Ordinance.

Commentary

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

(b) This principle 4.16 only extends to agreements which involve the institution of proceedings. Consequently, it would not be unlawful for a solicitor to enter into an agreement on a commission basis to recover debts due to a client, provided that the

agreement is limited strictly to debts which are recorded without the institution of legal proceedings.

2. Contingency Fee Arrangements

2.1 Contingency fee arrangements in contentious business are prohibited. A contingency fee arrangement is any arrangement whereby a solicitor is rewarded only in the event of success in litigation by the payment of any sum, fixed or calculated, either as a percentage of the proceeds or otherwise, even if the agreement further stipulates some minimal fee payable in any event, win or lose. A contingency fee arrangement is said to be unlawful on the grounds of public policy. To enter into a contingency fee arrangement is also considered professionally improper. See for example re *A Solicitor (1989) Civil Appeal 150 of 1988.*

2.2 Section 64(1)(b) of the LPO sets out a general prohibition on contingency fees, but is amplified by principle 4.16 quoted above. The effect of this is not only to outlaw simple no win no fee agreements, but also to outlaw arrangements whereby a solicitor's remuneration is dependent on success in litigation, whether at trial or by settlement.

2.8 Broadly the same principles also apply to counsel and their fees. See in particular paragraphs 124 and 60(A) of the Bar Code.

2.9 The prohibition is, however, relatively narrow and it should be observed that contingent, conditional or success related fees are permitted in non-contentious business. Similarly, the prohibition only extends to fee agreements which involve proceedings. It is therefore lawful for a solicitor to enter into an agreement on a commission or success basis to recover sums due to a client, provided the costs agreement is limited strictly to debt recovery without involving the institution of proceedings. As noted above, conditional fee arrangements are

permissible between a Hong Kong solicitors and an overseas lawyer, provided they are valid in the jurisdiction of that overseas lawyer.

2.10 It is finally interesting to note that a form of conditional fee is built into the supplementary legal aid scheme, "SLAS". In claims falling within this scheme, a legally aided plaintiff who is successful, pays back a percentage of the compensation awarded into the SLAS fund. Conversely, of course, if the case is lost, the fund will pay all the legal costs.

2.11 Contingency fee arrangements were reviewed in the consultation paper on legal services in 1995. That paper was written in the context of reforms on conditional fees introduced at that time in England. The consultation paper rehearsed the fairly well known arguments against contingency fees, a number of counter-arguments, and finally came down on the side of introducing reform to the restriction on contentious business contingency fees along the lines of those introduced in England. The position in Hong Kong is presently that conditional fees, or perhaps also contingency fees are being looked at. A Law Reform Commission committee was established in Summer 2003 to consider conditional fees, and is reviewing the position with the view to making recommendations. In parallel, the Law Society Working Party on Conditional and Contingency Fees has been reviewing the issues, leading towards this Forum with members.

2.12 Arguments on principle against the introduction of some form of contingency fee system may be summarised as follows:

(a) lawyers may be tempted to advise a client to accept a lower amount than the client could get through the courts, in order to avoid the risk of losing the case and the contingency fee;

(b) clients may be required to pay their lawyers a disproportionate amount of any sums recovered;

(c) an increase in speculative litigation could prejudice more deserving litigants, who need to redress their grievances through the judicial systems; and

(d) lawyers may be tempted to try to enhance their clients' chances of success, perhaps by coaching witnesses or withholding inconvenient evidence.

2.13 However, these disadvantages may be minimised by proper codes of conduct and through restrictions on the amount a lawyer is able to recover. In addition, a deterrent to speculative litigation exists in Hong Kong in the practice of normally requiring a losing party to pay the costs of the successful party. A potential litigant therefore needs to assess the risk of having to pay these costs. There is no such practice in US jurisdictions which allow contingency fees. A litigant who is represented on a contingency fee basis in the US will therefore pay nothing if he or she loses.

2.14 The arguments on principle in favour are said to be as follows:

(a) increased access to justice by those whose resources are above the legal aid threshold, but outside the category of those who are easily able to fund their own litigation;

(b) the creation of a flexibility between the lawyer and his client as to fee arrangements to suit the circumstances of the case, such as exists for non-contentious business;

(c) as a consequence of greater access to justice, more claims and more work;

(d) easier to challenge and regulate unauthorised debt collectors; and

(e) some evidence suggests that lawyers working on a contingency basis act more diligently and efficiently in pursuing cases, since they are funding it. The argument is that lawyers on an hourly rate are tempted to drag the case out and clock up hours.

3. The Practical Problem

3.1 The essential problem, which some form of conditional/contingency fee is aimed at addressing can be stated as follows:

(a) a potential client, normally a plaintiff, has a case to bring, or a defence to run;

(b) the client has some assets, and so is outside the scope of the regime of legal aid or SLAS;

(c) the client is, however, well outside the super-rich category of those who can litigate without caution;

(d) they find a lawyer who is prepared to act on a "no win no fee" basis; and

(e) if the case is prosecuted successfully, the client gets damages, and the lawyer gets paid an enhanced fee for taking the risk;

BUT:

(f) what if the case is lost? Who pays the legal costs of the other side?

(g) insurance could be taken out to cover this possibility, but what if insurance is unavailable and too expensive? Who pays the premium?

(h) while the case is going on, the lawyer may be prepared to wait for his fee, but who pays for disbursements, and, in particular, counsel?

(i) if the case is successful, who pays for the uplifted fee: if this comes out of the damages, is there anything left for the successful client?

(j) what happens if you win, but the defendant can't pay - you will not always know if a defendant is worth suing until you come to enforce a judgment. The lawyer has won and will want to be paid - is he taking on the risk of the defendant's poverty as well as the risk of losing the case?

(k) insurance could be taken out to cover the poor defendant situation, but again is this available and at what premium? Who pays that premium?

(l) the contingency or conditional fee could be charged to the losing defendant, leaving the plaintiff whole with his damages. In this case, the losing defendant will fight vigorously the contingency arrangement and satellite litigation will ensue. Is it fair that one losing defendant should pay 50% more costs than another losing defendant for the same case because he happens to have a plaintiff on a conditional fee? and

(m) working out which is the winning case to back can take time - who pays for that?

4. The Regime in England

4.1 The position now in Hong Kong is as England was before 1990. Section 58 of the Courts and Legal Services Act 1990 introduced a system of conditional fees in England. The system was brought into effect by the Conditional Fee Agreements Order 1995, and substantially overhauled in 2000. Further overhaul is presently underway.

4.2 Conditional fees were initially permitted only in personal injury, insolvency, and European Court of Human Rights actions. They were extended in 2000 to cover all civil proceedings except criminal and matrimonial matters, where it was thought the proceedings were likely to be highly contentious, so that lawyers acting on a conditional basis may be subject to greater improper influence.

4.3 Under the Access to Justice Act 1999, and the Conditional Fee Agreements Regulations 2000, a conditional fee arrangement ("CFA") may now be entered into in four main ways:

- No win no fee, success fee if win
- No win reduced fee, success fee if win
- Normal fee if win, no fee if lose
- Normal fee if win, reduced fee if lose

4.4 Reference also needs to be made to the Civil Procedure Rules (Parts 43-48) and practice directions on CFAs. Information is available from the UK Law Society website, including a sample CFA (www.lawsociety.org.uk). This regime is now all encompassing, and therefore any conditional fee arrangement which does not comply is outlawed. Accordingly, the "only charge fees if we win" arrangement permitted under the *Thai Trading* case is no longer permitted, unless a formal CFA is entered into.

4.5 A detailed review of the Regulations is beyond this note, but suffice it to say they are complex and detailed. Failure to follow the detail has resulted in serious adverse consequences in a number of cases. The essence is that full and frank information on all the terms and effects of the CFA must be explained to the client orally, and largely also in writing. Failure to give both the oral and written presentation has invalidated CFAs. The explanation must include the basis and calculation of any success fee, and when it is or is not payable. What happens if the case settles, and at what stage, and the effect of inter-partes taxation on liability for a success fee. When there is a liability for costs of any party or lawyer, and how this is funded. Legal Aid options and insurance taken out. The client must sign.

4.6 The amount of success fee uplift is capped by regulations at 100% (a limit reached after some significant controversy in the relevant parliamentary debates), but such an uplift is the exception. On taxation after trial, the court looks at the success fee against the nature of the matter, the work done, and the risk borne by the solicitor, and may (indeed frequently does) reduce it. In that case, the client's liability is reduced correspondingly - such an inter-partes taxation therefore effectively reduces the solicitor-own client success fee. If the case settles, the success fee is also limited to a percentage of the costs deal done with the opponent, unless part of the settlement is a costs assessment by the court. The basis for selecting a particular success fee must be explained to the client.

4.7 Insurance by the CFA plaintiff (or defendant) is normal to cover the potential to have to pay the other side if the case is lost. Insurance can be extended to cover the situation where the case is won, but the defendant is unable to meet the cost liability. The plaintiff's solicitors can take out insurance to cover their own costs in case the case is lost. Insurers normally demand

a good counsel's opinion, and the availability of insurance, and the premiums for it, has been a source of difficulty.

4.8 In the initial regime, there was no liability on the part of the losing defendant for the success fee or the insurance premium. This was changed by the regulations in 2000, so that now both the success fee and the relevant insurance premiums are recoverable by a successful party on inter-partes taxation. This itself has been the source of many problems, as discussed below.

4.9 A curious add-on is that third party agents engaged by lawyers may act on a pure contingency basis, except expert witnesses (*Factortame -v- Secretary of State* [2002] EWCA Civ 932).

5. The Use of CFAs in England

5.1 As always expected, CFAs have been used primarily and extensively for personal injury litigation. Such an arrangement is now more or less the norm for a personal injury matters, and it appears that more injured parties are making claims. It might be said that, therefore, the objective of increasing access to justice has been achieved. Nevertheless, there are a number of inter-related factors, which are sometimes difficult to separate:

- At the same time, there has been a significant cutback in the availability of Legal Aid. This inevitably means more potential plaintiffs are forced to enter in to CFA agreements.

- The availability of "no win no fee" has given rise to a whole claims industry, not only amongst personal injury lawyers, but also amongst insurers and financiers. No win no fee advertisements are now made, and 'Claims Direct' type companies promote themselves and advertise their services. This has raised awareness that claims are possible, and so more claims are brought.

- Undoubtedly, for the middle ranks of plaintiff, who is not wealthy, but was always beyond Legal Aid, making a claim is now a possibility. Such a plaintiff can, provided their case is thought to be good, bring a claim with no liability or exposure. Such claims would not have been brought before. The fact that the plaintiff can now litigate without care or caution, is balanced by the fact that only winning cases will be taken on by lawyers on a CFA basis.

- The year 2000 shakeup of the CFA regime is also inter-woven with the substantial shakeup of civil procedure at the same time. It is not always easy to separate the effect of pre-action protocols and procedural reforms from the effect of a CFA arrangement.

5.2 CFAs have also been used widely for libel claims, where Legal Aid was not available before. They are also used in cases where the solicitors would otherwise have acted pro bono and recovered nothing, but can now effectively act without charge, recovering costs from the losing opponent if the case is won. Almost all CFAs are for poor plaintiffs, and almost all are accompanied by some form of insurance arrangement, primarily to cover the risk of paying the other side if the case is lost.

5.3 CFAs are generally being used in relatively small, strong and simple claims. If an action can be seen at the outset to be strong, a CFA may be obtainable. If the claim involves significant work to assess whether it is good or not, if the merits are less certain, or if it is a complex commercial action, a CFA will not normally be obtainable. An injured plaintiff in a simply road accident case will get a lawyer to work on a CFA basis. In most of these cases, liability would not be in issue, and the case would never have come to court. This is all the more so with the enhanced compulsory pre-action protocols. On the other hand, the injured plaintiff

in a complex clinical negligence case is much less likely to find the lawyer who will act on a CFA basis.

5.4 CFAs are being used to a limited extent in commercial actions, although this is still the exception. Most large firms are refusing to act on a complicated commercial matter on a CFA basis, although this would now be lawful. There are exceptions, and some major clients are able to push through working on a CFA basis. There is some evidence that CFAs are helping in the insolvency sector, where liquidators, always short of funds, are able to take action to recover assets and bring claims on behalf of the insolvent estate for the benefit of creditors.

5.5 There has not apparently been any real issue over the classic fears surrounding CFAs, on the ground that lawyers are now acting improperly. There has been no explosion of ambulance chasing, and professional conduct rules on advertisement are being enforced and followed. Nevertheless, lawyers radio and TV ads now appear, where they did not before.

5.6 There does not appear to have been any explosion of speculative litigation: the fact that a CFA will only realistically be entered into in good cases has been a deterrent to this. I have discussed CFA arrangements with a number of UK lawyers who have acted on them. All say that they do not feel under any pressure to pursue an action, to settle it, or generally to act in any different way than in an ordinary case. The only difference is, slightly surprisingly, that a number of lawyers were prepared to confess that there were some temptation to be more cost effective in a CFA arrangement. In an ordinary case, where the client was paying for work done on a monthly basis, steps could be taken or not taken in the best interests of the case and the client, and with agreement of the client. Where the firm was funding the litigation until its ultimate conclusion, there was some temptation not to pursue all possible avenues, and so to keep costs streamlined. This may also in part be an effect of the new civil procedure rules, aimed at enhancing co-operation and reducing steps in litigation.

6. Some Issues

6.1 Perhaps the most controversial aspect of the English CFA arrangement was the change brought in in 2000 to allow the success fee and the insurance premium to be recoverable against a losing party. This has been the source of much debate and many difficulties. First, the losing party (normally a defendant) will say with some force why should they have to pay a success fee in one case, which is on a CFA arrangement, whilst in another case where there is no CFA they pay less? Why should a defendant who never intends to oppose liability have to pay a success fee and an insurance premium already incurred by the Plaintiff before they are given a change to respond to a claim?

6.2 This has led to substantial satellite litigation and dispute. First, Courts have exercised judicial control over the success fees, and the allowed amounts are being steadily reduced. Examples include 60% success fee reduced to 20% and 20% to 5%. It is now being suggested (*Woods - v- Chaleef* unreported 2002) that there should be a two stage success fee: one geared to an early settlement and a higher fee geared to a successful trial. There have been a significant number of cases where the matter has settled at an early stage without proceedings, but litigation has then commenced to deal with the costs and CFA only. This proliferation of satellite litigation clogs up the courts, and tends to deflect the purpose of the civil procedure reforms and pre-action protocols. It also involves the Court in an additional taxation and assessment exercise, for which they may not have time or be well equipped.

6.3 The plaintiff's solicitor is also aggrieved: a plaintiff and his solicitor enter into an arrangement, fully explained in accordance with the regulations and Law Society guidelines, which involves a 50% success fee. At the end of the day, the court reduces that to 20%. Not only does this affect inter-partes costs, but also means the solicitors cannot now enforce his contract with his client beyond the success fee permitted by the Court.

6.4 The CFA regulations are detailed and complex, and this has also resulted in significant satellite litigation. A losing defendant has, on many occasion, been able to overturn a CFA on the basis that some technicality has not been complied with (including where the written explanation was given correctly and in full, but not duplicated by an oral explanation). In order to evade liability for a success fee and insurance premium, defendants will go to significant lengths to fight the CFA on its technicality. The consequence of invalidity is not only that the successfully challenging defendant is not liable for costs, but since the fee arrangement is invalid, the plaintiff's solicitor cannot recover from his own client. A Court of Appeal decision in a number of test cases has made it clear that, in future, such mere technicality should not invalidate a CFA: something more substantial and material is needed. It does not seem to me that this really solves the problem: litigation over what is "material" will no doubt continue. Similarly, there is a difficulty with the Court of Appeal saying that parts of the CFA regulations and procedures do not in a sense matter: which parts do not matter, and if they don't why they are there? Simplification of the CFA arrangements is likely to be brought in.

6.5 The funding arrangements and insurance have also caused significant difficulty: at the outset, the Law Society arranged a £85 premium to cover liability to the other side in a CFA arrangement, in case the action was lost. Unfortunately, this was limited to 'panel' solicitors. Between 1995 and 1997, this rose to £161. Insurance premiums quickly rose again to £300-400, and now £700-1,000. In a medical negligence case, a plaintiff was asked to pay an insurance premium of £15,000 in order to obtain cover against as a potential cost liability of £100,000. In simple personal injury cases, the insurance premium comes close to the likely costs of an undefended action. 90% rated actions are the norm for CFAs. 50/50 or even 60/40 will have trouble getting CFA cover. This is proving an obstacle to an effective CFA arrangement.

6.6 It is the solicitor that bears this burden. A typical arrangement is backed by both insurance and financing. The solicitor takes out a loan for his fees from a finance company, which includes a loan for the insurance premium, and disbursements. If the case is successful, the plaintiff's solicitor recovers his fees from the other party, together with the insurance premium and success fee. The success fee may, of course, be cut back by the court. The solicitor pays the funding costs. If the case is unsuccessful, the insurance company pays the plaintiff's solicitor costs-effectively repaying the loan.

6.7 The burden is heavy, with preparing the CFA, getting insurance and counsel's opinion, and complying with pre-action protocols giving rise to substantial front-loading. Explaining the CFA to the clients is complex, and clients and lawyers alike are struggling to understand it.

7. Some Ideas

7.1 Simply amending the LPO to allow flexibility of fee arrangement between solicitor and client, without the uplift or contingency fee being payable by the other side would go a long way.

7.2 Professional conduct rules could ensure the client understands this private deal with his solicitor, and that he is not over-charged.

7.3 Even if insurance is not available, this arrangement will be useful in insolvency, pro bono and commercial matters, and some personal cases, and does no harm.

7.4 Insurance is key to making the flexibility of wider benefit.

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