



**WORKING PARTY ON
CONDITIONAL FEES**

RESPONSE

**LAW REFORM COMMISSION'S
REPORT
ON CONDITIONAL FEES**

September 2007

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ABBREVIATIONS

ATE insurance	After the event Insurance
CFA	Conditional Fee Agreement
CFAs	Conditional Fee Agreements
CJC	The Civil Justice Council, England
CLAF	Conditional legal aid fund
DCA	Department for Constitutional Affairs of The British Government
DLA	The Director of Legal Aid
DOJ	Department of Justice
LAD	Legal Aid Department
LASC	Legal Aid Services Council, Hong Kong
LRC	The Law Reform Commission of Hong Kong
LSC	The Legal Services Commission, England
LSCE	Legal Services Council, England
LSEW	The Law Society of England and Wales
MOJ	Ministry of Justice, England
OLAS	Ordinary Legal Aid Scheme
SLAF	Supplementary Legal Aid Fund
SLAS	Supplementary Legal Aid Scheme

1. Introduction

- 1.1 The Working Party on Conditional Fees (“the Working Party”) was first convened by the Council of the Law Society on 4 October 2005 to study the Consultation Paper on Conditional Fees (“the Consultation Paper”) published by the Conditional Fees Subcommittee of the LRC on 14 September 2005.
- 1.2 The Working Party’s comments on the Consultation Paper and their specific responses to the 13 recommendations of the LRC (“the Working Party’s First Report”) were considered and adopted by the Council on 7 February 2006 and were sent to the LRC on 14 February 2006.
- 1.3 The Working Party was reconvened by the Council on 10 July 2007 to study the Report on Conditional Fees published by the LRC in July 2007 (“the LRC Report”) with the following terms of reference:

“To consider the implications of the Report of the LRC on Conditional Fees July 2007 and to advise the Council accordingly.”

- 1.4 The Working Party comprises:

Members: Mr. Michael J. Lintern-Smith (Chairman)
 Mr. Patrick M. Burke
 Mr. Joseph W.K. Chan
 Ms. Barbara A. Hung
 Mr. Ludwig S.W. Ng
 Ms. Szwina S.K. Pang
 Mr. Richard K.C. Tsun
 Mr. Tommy K.M. Wong

Secretary: Ms. Vivien Lee

- 1.5 The Working Party submitted this Response to the Council on 25 September 2007 and the Response was adopted by the Council. Hence, the views of the Working Party represent the views of the Law Society.

2. General Comments on the LRC Report

- 2.1 The LRC studied the costs system in many jurisdictions including an in-depth study into the problems and the reforms in England, the conditional fee system in Australia, and contingency fees in U.S.A. and Canada.

- 2.2 The LRC concludes that whilst there are disadvantages to CFAs, such disadvantages should be balanced against the improvement in access to justice, especially for the middle income group. The LRC remains of the view conditional fees would improve access to justice.
- 2.3 The Working Party agrees that access to justice is fundamental to the rule of law and the effective operation of any legal system. However, as the CJC stated in its first report¹ on funding options and reiterated in its second report², the delivery of access to justice is dependent upon:
- (i) a meritorious case
 - (ii) the participants having at the outset access to means of funding their case
 - (iii) the lawyers on each side having at the outcome access to reasonable remuneration
 - (iv) the cost of (ii) and (iii) being proportionate to what is at stake
 - (v) the availability of an efficient and properly resourced court system
- 2.4 The Working Party notes that the Government is also committed to ensuring access to justice. In the Fifth Anniversary Reception of the LASC in January 2002, the Chief Secretary for Administration stated:
- “Through the provision of publicly funded legal aid services, the Government seeks to ensure that no one with reasonable grounds taking legal action in Hong Kong is prevented from seeking justice because of a lack of means”.
- 2.5 The Chief Secretary further affirmed the “crucial role” of legal aid services in facilitating access to Hong Kong’s system of administration of justice, so that the rule of law might be upheld through the protection of rights of individuals and ensuring that all might enjoy a level playing field in their activities.

¹ ‘Improved Access to Justice – Funding Options & Proportionate Costs’, Report & Recommendations, CJC, August 2005

² ‘Improved Access to Justice – Funding Options & Proportionate Costs’, The Future Funding of Litigation – Alternative Funding Structures, CJC, June 2007

- 2.6 The Working Party has set out in detail in its First Report the English experience with CFAs. The Working Party submits the English experience shows that CFAs do not fulfil the criteria in paragraph 2.3 of this Response in bringing access to justice. In fact, the English system is moving towards a fixed costs/fixed success fees regime and deregulation to cure the anomalies of CFAs.
- 2.7 The Working Party is aware the DOJ commissioned a three-year consultancy study on the demand for and supply of legal and related services in Hong Kong in 2004. The Working Party has been advised by the DOJ the field work for the study is completed and the findings may be published at the end of 2007.
- 2.8 The Working Party reserves the right to submit a supplementary report on the publication of the findings of the consultancy study.
- 2.9 The Working Party remains of the view CFAs cannot improve access to justice and the LRC's recommendation to expand SLAS is the way forward.
- 2.10 The specific responses of the Working Party to the 10 recommendations of the LRC are set out in Sections 3 to 5 of this Response.

3. Response to Recommendation 1

- 3.1 *Having regard to the likelihood that ATE insurance to cover the opponent's legal costs should the legal action fail would not be available at an affordable premium and on a long-term basis in Hong Kong, the LRC believes that conditions at this time are not appropriate for the introduction of conditional fees, save in the circumstances set out in their recommendation of CLAF.*
- 3.2 The Working Party submits that CFAs should not be introduced in Hong Kong at all, not least because of the unavailability of ATE insurance at affordable prices, but because of the disadvantages of CFAs as set out in detail in pages 14 to 16, 23 to 27, 33 to 37 of the Working Party's First Report. These are summarized as follows:
- (i) CFAs exacerbate the conflict of interest between the solicitor and his client as the solicitor's direct financial interests are aligned with the client's
 - (ii) The escalation of the costs of litigation

- (iii) The creation of a new industry of costs negotiators
- (iv) The increase in satellite litigation
- (v) CFAs encourage the activities of unregulated and unqualified claims intermediaries
- (vi) CFAs have been used in England as a substitute for legal aid
- (vii) The possibility of nuisance or unmeritorious claims
- (viii) The increase of financial burden of solicitors
- (ix) Solicitors are exposed to an adverse costs order as a funder of litigation under the ruling in Arkin-v-Borchard Lines Ltd. (2005) EWCA Civ. 655
- (x) The introduction of CFAs may have the same effect on the legal profession as the abolition of scale fees has in conveyancing, namely, it will create an environment for cut-throat prices to be offered for legal services

3.3 The British Government attempted to combat satellite litigation by shifting the client-care provisions in the legislation to professional codes of conduct. The Conditional Fee Agreements Regulations 2000 and Collective Conditional Fee Agreements Regulations 2000 were revoked in England with effect from 1 November 2005 and the LSEW introduced a new Law Society Code of Conduct. The British Government will review the new regime 3 years after their implementation. Meanwhile, in their report³ to the Lord Chancellor “Improved Access to Justice – Funding Options & Proportionate Costs”, the CJC made the following observations on the CFAs regime in England since the reforms in 2005:

- (i) The Government relied on proposals to simplify the conditional fee regime by transferring the client care aspects into Law Society regulations. These were implemented following the [then] DCA Consultation Paper “Making Simple CFA’s a reality”. Whilst this reform was welcome it stemmed a major element of satellite litigation, and has not stopped the “costs war” (it merely diverted), and challenges to ATE premiums and recoverability continue.

³ ‘Improved Access to Justice – Funding Options & Proportionate Costs’, The Future Funding of Litigation – Alternative Funding Structures, CJC, June 2007

(ii) A combination of adverse market behaviour, susceptibility to technical court challenges on levels of ATE premium, high referral fees, and the potential impact of Government proposals for the reform of the personal injury claims process mean that the stability of the ATE market is vulnerable with a consequence on CFAs. Should any one or a combination of these effects reduce ATE coverage, CFAs may fail as a result.

3.4 The English experience shows that notwithstanding the availability of ATE insurance and the reforms of the Government, the CFAs regime continues to create problems.

4. Response to Recommendation 2

4.1 *It is recommended that SLAS be expanded on a gradual and incremental basis, by, firstly, raising the financial eligibility limits and secondly, by increasing the range of cases covered, having regard to maintaining the financial viability of SLAS.*

4.2 The Working Party supports the recommendation to expand SLAS save that it does not see the need to advance the expansion by stages.

4.3 The Working Party considers SLAS to be the most practical means of increasing access to justice. Given the current economic upturn, the seed money required for the extension of SLAS is well within the Government's budget. Otherwise, the seed money can be provided by charities as in the case when SLAS was first established. Please refer to paragraph 4.11.

4.4 In fact, by raising the financial eligibility limits of the applicants and their contributions, it will not be necessary to raise seed money for the expansion.

4.5 The Working Party notes that the CJC visited Hong Kong to study SLAS and in their recommendations to the Lord Chancellor⁴, they suggested SLAS be established in England to be operated by the LSC.

4.6 The CJC suggested 4 models for SLAS⁵:

(i) Model A:

⁴ 'Improved Access to Justice – Funding Options & Proportionate Costs', The Future Funding of Litigation – Alternative Funding Structures, CJC, June 2007

⁵ Ibid.

This model operates like normal legal aid except a successful client pays an additional contribution out of damages recovered into the fund set up for SLAS. The legal aid costs protection under S11 of the Access to Justice Act 1999 and the Civil Legal Aid (Costs Protection) Regulations 2000 applies so that a funded client is only liable for any adverse costs order to the extent the Court considers it reasonable in all the circumstances including his or her financial resources. Since by definition the funded client who has been found financially eligible will have limited assets, it is very rare for any costs order or part of a costs order to be enforced against a funded client.

Model A follows SLAS in Hong Kong except that there is no protection from adverse costs order and SLAS is responsible for paying the costs of the successful opponent and the lawyer of the legally aided person in Hong Kong.

The contribution paid out of damages was reduced from 12% to 10% in December 2005 in Hong Kong. The CJC doubted whether a 10% levy on damages would be adequate to ensure the fund could be self-financing in England.

To preserve the principle of proportionality, the CJC suggested the contribution should be capped by reference to costs e.g. a levy of say 10% on damages should be subject to the safeguard that the levy must not exceed 100% of the total costs of the funder at legal aid rates.

(ii) Model B:

Model A is modified to the extent the levy is imposed on the costs recovered in successful cases, instead of damages. The CJC proposed the levy be restricted to costs and counsel fees, but not the other disbursements. The CJC acknowledged this model would not enable the fund to be self-financing and suggested this model be combined with other models.

(iii) Model C:

Models A and B are modified to the extent the levy on damages and/or costs of the successful claimant is recoverable from the opponent, but the costs protection for legally aided litigants under

S11 of the Access to Justice Act 1999 and the Civil Legal Aid (Costs Protection) Regulations 2000 remains.

(iv) Model D:

Model C is modified to the extent the levy on the successful claimant's damages and/or costs is recoverable from the opponent, but also the liability to pay the opponent's costs is covered by insurance.

Model D has similarities with the CLAF suggested by the LRC in that the levy on damages is calculated on a contingency fee basis whereas recoverability of the levy and costs are based on CFA. (Please refer to paragraph 5 of this Response).

There are however significant differences: ATE insurance is not available in Hong Kong and there is no costs protection as provided by the Access to Justice Act and the Civil Legal Aid (Costs Protection) Regulations.

- 4.7 The CJC considered Models C and D gave the greatest safeguards to the claimants, but raised serious issues of fairness to the defendants and long-term viability. Models C and D place prime importance on recovery of inter parties costs. This may create an incentive for the defendants to settle early but conversely may encourage the claimants to issue proceedings to recover full costs, thus giving rise to a fresh round of satellite litigation.
- 4.8 The CJC suggested to the Lord Chancellor to conduct detailed financial modelling of the options, to be followed by consultation with the LSCE and the MOJ. Their provisional recommendation was to adopt Model A, being the most promising and simplest model for SLAS. It is gratifying to know that the system in Hong Kong is receiving commendation from overseas jurisdictions.
- 4.9 The CJC did not make any specific recommendation on the types of cases to which SLAS should apply, but suggested it could first be implemented in cases within the existing scope of legal aid, and extending it gradually to those outside the current legal aid scheme, particularly those sandwich class who are above legal aid eligibility limits.
- 4.10 The CJC did suggest that if SLAS could become fully self-financing (including covering any additional administrative costs) for a given type of case, then logically all financial eligibility criteria for legal aid could be

abolished. However, the CJC qualified their statement by conceding that no matter how much detailed financial modelling were to be undertaken, there would always be uncertainty as to how a SLAS would operate until it was put in place. It is therefore impossible to predict confidently that a SLAS will be fully self-financing, without a start up that leans heavily on the side of imposing a very substantial (and probably unacceptable) levy on client damages or costs.

- 4.11 In Hong Kong, SLAS has been established since 1 October 1984. At its inception, the Lotteries Fund set aside a loan facility of HK\$1 million to be drawn upon for setting up SLAF. SLAS became self-financing in the 1990s without having to draw on the entire loan at any one time. As at 30 September 2005, the net assets of SLAS were HK\$93,266,655.
- 4.12 In their response to the Consultation Paper⁶, the Government set out the following objections to expanding SLAS:
- (i) The Government estimated that about 55% of households in Hong Kong were financially eligible for OLAS, and about 15% of households in Hong Kong were financially eligible for SLAS. Hence, the percentage of households covered by OLAS and SLAS together was already 70% of the population.
 - (ii) For SLAS to remain self-financing, SLAS had to concentrate on cases with a high success rate and a high damages to costs ratio. There was therefore little scope for expansion.
 - (iii) The contribution rate for SLAS had been reduced from 12% to 10% of the damages awarded. The SLAF of HK\$93 million as at 30 September 2005 was the total accumulation since 1984 and included a HK\$27 million Government injection in 1995. The reduction in the rates of contribution has led to a steady reduction in the annual surplus in recent years. There was little scope for SLAS to absorb other types of civil cases.
 - (iv) Although SLAS had a higher financial eligibility limit than OLAS, the target group continued to be persons with limited means. If that ceased to be the case, there would be little policy or operational basis for SLAS to be operated by the LAD.

⁶ Response to The Law Reform Commission of Hong Kong Conditional Fees Subcommittee Consultation Paper on Conditional Fees By The Administration Wing of the Chief Secretary's Office and the Legal Aid Department

- 4.13 At the moment, SLAS is only available to claims involving personal injury and death, including those caused by medical, dental, legal professional negligence, where the claim for damages exceeds or is likely to exceed HK\$60,000; and claims under the Employees' Compensation Ordinance Cap. 282 irrespective of the amount claimed. Like OLAS, applicants have to pass the means test and the merits test.
- (i) Means test – the financial resources (the aggregate of annual disposal income and disposal capital) of the applicant should be above HK\$162,000 but not exceeding HK\$450,800. The benchmark for setting the means test is “public affordability”.
 - (ii) Merits test – there should be reasonable grounds for taking proceedings. The likelihood of success of the claim and the benefits to the applicant are evaluated. Benefits refer not only to the damages awarded but also to the other redresses including protection of public interest.
- 4.14 The Working Party submits SLAS should be expanded to cover other types of cases and only the super rich should be excluded from SLAS.
- 4.15 The Working Party agrees that the financial viability of SLAS is essential to its sustainability, but suggests that SLAS can still be expanded to cover other types of cases which have a high success rate and certainty of recovery of damages. These 2 criteria are already included in the merits test and if they are fulfilled in any types of cases, there is no reason why SLAS should not be extended to cover them.
- 4.16 Subject to any financial modelling to be conducted by the Government, the Working Party submits SLAS should be expanded to cover all claims instituted in Hong Kong, including counter-claims, arbitrations and mediations and proceedings in the Labour and Lands Tribunals, where the recovery of money or the restoration of real property is the primary remedy, (so that there is a money fund from which contributions can be obtained) except for actions for defamation and maintenance for children. Therefore, in addition to the types of cases already covered by SLAS, SLAS should be extended to:
- (i) commercial cases in which the primary remedy is damages;
 - (ii) product liability and consumer cases;

- (iii) probate;
 - (iv) all cases in the Lands Tribunal;
 - (v) judicial review;
 - (vi) any claims for recovery of property;
 - (vii) trade marks and patents;
 - (viii) shareholders' disputes;
 - (ix) trust;
 - (x) employment disputes;
 - (xi) partnership disputes.
- 4.17 Actions for defamation and maintenance of children are excluded because of the risk of abuse. In the case of defamation, it would not be cost-effective to run the claims on SLAS given the possibility the amount of costs involved is likely to outweigh the nominal damages awarded.
- 4.18 The Working Party notes that the Legal Service Research Centre in Northern Ireland conducted an analysis⁷ of the profiles of damages recovered from claims funded by legal aid in 2001 and concluded that based on the outputs from the statistical model used, a CLAF scheme financed by levies on damages or costs could operate on a self-sufficient basis. Legal aid in Northern Ireland covers criminal and civil matters. In addition to matrimonial, personal injury, general medical negligence claims, which are also covered by OLAS or SLAS in Hong Kong, civil legal aid in Northern Ireland covers bankruptcy, injunctions and judicial reviews.
- 4.19 The Working Party would urge the Government to commission a similar statistical analysis to ascertain whether a levy imposed on the damages and/or property and/or costs recovered in the successful cases in the categories of claims in paragraph 4.16 could enable SLAS to continue to be self-sufficient.

⁷ Report of the feasibility of a CLAF scheme for Northern Ireland, Legal Service Research Centre, July 2001

- 4.20 In the absence of statistical evidence, it cannot be stated with certainty that there is little scope for expanding SLAS into other types of cases.
- 4.21 The Working Party concurs with the view of the CJC that if it can be proved SLAS is self-sufficient on the types of claims covered, there is no reason why all financial eligibility criteria should not be abolished.
- 4.22 In its publication “Legal Aid in Hong Kong”⁸, the LASC made the following observations about the mechanics and the philosophy behind the current means test:
- (i) The means test attempts to accommodate a legal aid applicant with a certain standard of living. Therefore, allowances for household expenditure are to be deducted from the financial resources to ascertain eligibility for legal aid. The allowances are set to be equivalent to the “35-percentile household expenditure”. The LASC questioned whether the same level of allowances should be applied in OLAS and SLAS, given different financial eligibility limits apply to the 2 schemes. The LASC had previously suggested raising the level of allowance to 50% in the case of applicants under OLAS and 75% in the case of applicants under SLAS but these proposals were rejected by the Government.
 - (ii) The LASC also questioned the basis of adopting the 35% percentile. The LASC sought advice from Dr. Wong Hung of the Chinese University of Hong Kong in 2003 on issues concerning the financial eligibility limits of legal aid applicants. Dr. Wong was of the view that the 35-percentile household expenditure standard was not “an appropriate level to reflect the expenditure of the lower middle class and below”. The level should be set at 66-percentile. Working population’s occupation and employment status data collected by the Population Census 2001 showed that 66.4% of the working population in Hong Kong were below the cutting line of the upper and lower middle class. The 35-percentile household expenditure standard, according to Dr. Wong, appears to represent the cutting line between the “underclass” (defined by reason of the household head not working) and the “working class” (defined by reason of the household head working).
 - (iii) The 35-percentile household expenditure standard for deductible allowances assumes all legal aid applicants have the same spending

⁸ Legal Aid in Hong Kong, Legal Aid Services Council 2006

needs. This “across the board” approach does not address the needs of different social classes, not to mention individual needs and case-specific affordability.

- (iv) The benchmark for setting the financial limits of the applicants for legal aid in the means test for both OLAS and SLAS is “public affordability”. The philosophy is this: When a person is faced with legal proceedings, he would draw on both his income and capital to meet his legal costs to the extent that he can do so “without suffering undue hardship”. The LASC questioned whether “undue hardship” should be interpreted, in the context of living standard, to a minimum or barely tolerable level, or a level of comfort below which it would be undue for the living standard previously enjoyed by the applicant’s household to fall, as a result of the legal proceedings drawing on the financial resources of the household.

The LASC pointed out the following categories of people who might not be able to “afford” legal proceedings if “affordability” were to be understood in the latter sense:

- Many living expenses of a middle-class household, especially those relating to the raising and education of children, are relatively committed. Therefore, unless one is determined to prosecute or defend the litigation it is unlikely one would divert available but finite resources in substantial terms to pay for the legal expenses as the decline in the standard of living will have been too steep for the whole family, including the children, to endure. An “across the board” living expenditure deduction of 35-percentile, pegged to “basic needs”, while easy to administer in relation to the use of public moneys, does not adequately recognize the reluctance of the middle-class to re-allocate priorities to face litigation.
- Older persons may also have a similar reluctance in committing their savings to litigation expenses, since poorer employment prospects and retirement together mean that, unlike younger working persons, it is less probable for depleted savings to be replenished so that they may live through the latter years. The possibility of recovery of legal expenses when the case is won is not an incentive towards committing savings, or as it is gradually the case, the pay-out from the mandatory provident fund, since one cannot be sure of winning a case eventually and the fact that the litigant may apply for legal aid when his financial resources

dwindled below the financial eligibility limit does not mean that legal aid would be granted to him in due course.

- Retired persons in particular do not have a stream of income. Their mentality is to hold on to the savings in a disposable form without taking the risk of investment to generate an income, so that when illness or death comes, there may be money to meet the necessary expenditure. The same applies to those who are disabled. It is noteworthy that bank savings are not excluded from the assessment of disposable capital. The means test therefore fails to recognize that where a person who has retired, or disabled and who derives his income principally from capital, his standard of living will be permanently eroded, in contrast to the temporary erosion suffered by someone paying out of current income. Those with erratic income or living on past savings are at a disadvantage when it comes to eligibility.
- (v) The LASC suggested it is probable the existing financial eligibility limits and assessment mechanism do not provide the intended coverage with the result only the underprivileged and super rich may have unimpeded access to justice.
- (vi) Periodic review and revision of the means test limits and methodology since 1994, while enabling a review to be conducted at fixed intervals of time, may not turn out to be sufficiently responsive to changes in the number of people eligible for legal aid, bearing in mind the absence thus far of reliable data of changes in litigation costs, a key data to measure “lack of means”.
- 4.23 The Working Party submits that the existing financial eligibility limits and assessment mechanism are inconsistent with the policy objectives of the Government on improving access to justice and on legal aid as stated in paragraphs 2.4 and 2.5 of this Response.
- 4.24 It is noted that the Government reiterated the same policy objectives in its response to the Consultation Paper.
- 4.25 The Working Party agrees with the LASC that there is in any event merit for greater exercise of the discretion by the DLA on granting legal aid notwithstanding the financial resources of the applicant. Under S32(3) of the Legal Aid Ordinance Cap. 91, the DLA has the power to waive in whole or in part the interim and final contributions in SLAS where he is satisfied it would cause serious hardship and it is in all the circumstances

just and equitable to do so. Under S5AA of Cap. 91, the DLA may waive the upper financial limits in OLAS in which a breach of the Hong Kong Bill of Rights Ordinance Cap. 383 or an inconsistency with the International Covenant on Civil and Political Rights as applied to Hong Kong is an issue. The Working Party submits there is merit in expanding the power of the DLA to waive the financial eligibility limits in SLAS and the waiver should cover deserving cases such as serious criminal cases, constitutional and human rights cases, and test cases involving important or broad legal or social issues.

4.26 According to the Income and Expenditure accounts of SLAS for the year ended 30 September 2005, the contributions from aided applicants had dropped from HK\$6,912,436 in 2004 to HK\$2,790,398 in 2005 i.e. about 59.6%, and investment income of the Fund was HK\$1,676,182, about 1.8% of the total accumulated surplus of HK\$93m. The DLA is empowered to invest the moneys of SLAF in such manner as the Financial Secretary may approve under S29(4) of Cap. 91. According to the LASC, surplus monies in SLAF are placed on fixed deposits with authorized institutions to earn interest.

4.27 The Working Party submits the financial viability of SLAS can be enhanced by:

- Investing in assets with better returns
- Increasing the levels of interim and final contributions. It was noted the levels of contributions were reduced in May 2000 and December 2005
- Different levels of contributions should apply to applicants of different means
- Adjusting the processing fees
- The Monitoring Committee in the LAD should closely monitor those cases which are defined as high risk and those for which considerable costs have been incurred and to review the cash flow and management of SLAF periodically, to enable early input both as to the grant or otherwise of legal aid and the future conduct of highly complex and sensitive cases
- Closer supervision of the conduct of litigation

- More stringent tests on merits and recoverability
- The implementation of costs protection rules similar to the provisions in England. Regulations can be made to restrict the scope of costs protection, specify the principles to apply in determining costs which may be awarded against a funded client, and limiting the circumstances in which an order for costs can be enforced against such a client

4.28 The Working Party however accepts the view of the CJC that until a SLAS is put in place, no matter how much detailed financial modelling is undertaken, it may not be possible to predict the SLAS will be self-sufficient, unless the model leans heavily on a high percentage of levy on damages and/or costs. One Member of the Working Party suggests that in order not to disturb the established financial viability of the existing SLAS, a separate SLAS (for cases which are not already covered by SLAS) should be established for the expansion, with the seed money provided by charities or loans. The Working Party submits that if a separate SLAS is to be established, there is merit in considering a combination of Models A and B suggested by the CJC in paragraphs 4.6(i) and (ii) of this Response.

5. **Response to Recommendations 3 to 10**

- 5.1 *It is recommended that a new fund, the CLAF, should be set up together with a new body to administer the fund and to screen applications for the use of conditional fees, brief out cases to private lawyers, finance the litigation, and pay the opponent's legal costs should the litigation prove unsuccessful. It is further recommended that CLAF should be permitted to engage the private lawyers it instructs on a conditional fee basis, while in the same way as SLAS will charge the client on a contingency fee basis. CLAF should initially accept applications from claimants only, but the long-term goal is for CLAF to also cater for defendants after CLAF has built up adequate reserves.*
- 5.2 The major difference between SLAS and the type of CLAF recommended by the LRC is that SLAS acts as a kind of mutual insurance fund which would insure each aided litigant against the risk of losing his action and having to pay both his own and his successful opponent's costs out of his own pocket. SLAS does so by paying the costs out of SLAF. In return, the aided litigant would pay a percentage of his damages if he succeeded. The contribution collected in successful cases would in turn constitute SLAF from which the aided litigant's and his opponent's costs would be paid in unsuccessful cases.

- 5.3 With the CLAF suggested by LRC, even though a contribution is collected in successful cases, the contribution only goes to pay the costs of the opponents in unsuccessful cases, any irrecoverable costs of the successful claimants and presumably the administrative costs of running the CLAF. The solicitors in unsuccessful claims in effect become the funder of the unsuccessful litigation.
- 5.4 The Working Party submits that this is introducing CFAs through the back door. As such, the model will encounter the same problems with CFAs as set out in the Working Party's First Report and summarized in paragraph 3 of this Response.
- 5.5 Given the unavailability of ATE insurance at affordable prices, a fact which the LRC has already acknowledged, it is difficult to see how CFAs can be tenable within a CLAF, if it cannot survive in the open market.
- 5.6 It is not clear from the LRC Report whether there will be a success fee and whether the success fee is recoverable from the opponent under CLAF. If the success fee is recoverable, this is bound to create a 'costs war' leading to satellite litigation. If the success fee is not recoverable from the opponent, the claimant whilst recovering his damages, will be subject to 2 charges, a contribution to be paid to CLAF and his solicitor's uplift. The position of a successful applicant under CLAF is therefore worse than one under the present litigation system in Hong Kong, except that he does not have to finance his litigation upfront.
- 5.7 The LRC states that allowing only a CLAF to employ conditional and contingency fees would have the added advantage that the common law offences of maintenance and champerty could be retained. However, the Working Party notes that unless ATE insurance is available, a solicitor is extending credit to the unsuccessful claimants under CLAF on expert fees, court fees and counsel fees. This still raises legal issues of champerty and maintenance, which remains a crime in Hong Kong. As a funder of the litigation, the solicitor may also be exposed to potential liability to an adverse costs order if his client loses, according to the ruling of the English Court of Appeal in Arkin-V-Borchard Lines Ltd. (2005) EWCA Civ 655.
- 5.8 The LRC suggests young members of the legal profession to make use of CLAF to gain experience. Litigation is notoriously uncertain. Extraneous and unforeseen circumstances may affect the outcome of a claim. Most litigators will have experience of cases which on law and facts, should have succeeded but did not e.g. the judge may take against a client, an experienced expert witness may suddenly unravel in the witness box, the

client may have withheld important evidence which affects the merits of his claim. There is no way of predicting when such unexpected events might strike. Indeed, the Working Party had already highlighted in its First Report the advice of the LSEW for firms to run successfully on CFAs. The LSEW advises law firms will have to implement clear internal protocols on screening cases for CFAs; a computerized case management system to track the progress and costs exposure of CFA cases; the compilation of a manual on the firm's policy on financial and risk management issues, model forms and checklists to ensure compliance with rules of professional misconduct, client care letters, insurance details etc. Comprehensive risk management measures are essential to ensure the success fees on 'wins' outweigh the potential fees and costs sacrificed on the 'losses'. The consequence of getting the risk assessment wrong or simply not undertaking the exercise can have far-reaching consequences. The failure of a number of prominent claims intermediaries in England is a testimony to the necessity for risks and case management.

- 5.9 The Working Party submits given the difficulties of running CFA cases successfully, young and inexperienced solicitors are at a particular disadvantage under CLAF.
- 5.10 The LRC proposes mediation be utilized in the process of resolving claims made under CLAF and a sanction of adverse costs order be imposed for any failure to attempt mediation. A claimant will suffer double jeopardy if he loses his claim in the proceedings, in that he is exposed to the other side's costs and an adverse costs order for failure to mediate. The burden will ultimately fall on CLAF, making it financially vulnerable. The solicitor funding the unsuccessful litigation also faces double jeopardy. He is not able to recover his costs and he faces a possible claim for professional negligence for failing to advise his client to attempt mediation.
- 5.11 The problems with CLAF aside, the Working Party submits that SLAS is better than CLAF in the following respects:
- (i) If the existing SLAS is expanded, there is no need for seed funding. It is uncertain at the moment whether any seed funding for CLAF will be available. Potential sources of seed funding are public funds, commercial litigation funders, other financial lenders and charity/lottery funds. The Working Party suggests research be conducted by the Government as to the availability of such funding, whether the Treasury, commercial litigation funders, or charities have any interest in contributing to a funding pool that would be allocated by another body when assessing which cases to support.

- (ii) It is doubtful whether a CLAF can co-exist with OLAS and SLAS. CLAF will suffer from adverse selection in that it will only attract those applicants who are not eligible or who are rejected by OLAS and SLAS. Unlike CLAF, a claim made under SLAS does not have to be 100% self-financing provided the recovery from the successful cases on the whole is proportionately higher than the costs paid in the unsuccessful cases. If however a CLAF suffers from adverse selection, it may be essential for all cases selected to be self-financing. As long as adverse selection exists, a CLAF may be attractive in theory but unworkable in practice.
- (iii) The problems of seed funding and exposure to the other side's costs in losing cases and adverse selection in competition with OLAS and SLAS all cast doubts over the financial viability of CLAF. The expansion to cover defendants is likely to increase its vulnerability as the defendants will not be awarded damages and the levy can only be imposed on costs.
- (iv) It is not necessary for SLAS to be viable year on year. The profitability of a SLAS may vary from one year to another without necessarily jeopardizing its continuation.
- (v) Under SLAS, a claimant's solicitor is paid whether the claim is successful or not. Under the CLAF model proposed by the LRC, the claimant's solicitor is not paid if the claim is unsuccessful.
- (vi) The CJC is of the view there are significant administrative savings for a SLAS administered by legal aid authorities compared to a separately administered CLAF. The administrative costs are fully covered by the SLAS levy. If SLAS is expanded in Hong Kong, the increase in administrative costs is likely to be less than the costs of establishing a CLAF. The costs of expansion should in any event be absorbed by the contributions from damages if the suggestion of the Working Party is adopted, namely that whilst SLAS is expanded to cover other cases, only those which fulfil the criteria of high success rate and certainty of recovery of damages are granted assistance.
- (vii) Under SLAS, the percentage deduction from the award of damages would go into SLAF and not to the lawyers (who would be remunerated in the usual basis). Therefore the perceived abuses of the contingency fee system in the United States stemming from lawyers having a direct financial interest in the outcome of the cases

can be avoided. Under CLAF, if the model proposed by the LRC is adopted all the disadvantages of CFAs including the conflict of interest between the solicitor and his client cannot be avoided.

- 5.12 In their latest report on funding options⁹, the CJC did not recommend the establishment of a CLAF in England. Whilst CLAFs can be successful, the CJC acknowledged that it suffered variously in other jurisdictions from insufficient seed funding, adverse selection, and even where successful, expansion into higher risk (losing) cases that reduce income may threaten the CLAF.
- 5.13 Given the difficulties with CLAF and the advantages of SLAS over CLAF, the Working Party submits that SLAS should be expanded in place of establishing a CLAF in Hong Kong.

6. Conclusions

- 6.1 The Working Party maintains that the disadvantages of CFAs outweigh its possible advantage as a means of increasing access to justice. A CLAF as suggested by LRC is unlikely to be financially viable, and untenable given the unavailability of ATE insurance in Hong Kong and the other problems discussed in paragraphs 5.4 to 5.9 of this Response.
- 6.2 The Working Party submits the increase in the number of unrepresented litigants in Hong Kong suggests there is a gap in access to justice. This demands the Government to review the scope of legal aid, and in particular SLAS. The Working Party recommends steps be taken by the Government to conduct statistical analysis and financial modelling with a view to expanding SLAS.
- 6.3 The Working Party believes that if SLAS is expanded to include other types of cases which have a high chance of success and certainty of recovery of damages or restoration of property, then the expansion will not jeopardize its financial viability. In any event, budgetary considerations of the Government should not and should not be seen to take precedence over basic rights and access to justice.

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⁹ 'Improved Access to Justice – Funding Options & Proportionate Costs', The Future Funding of Litigation – 'Alternative Funding Structures, CJC, June 2007