# DBAs under scrutiny

Leading experts examine the impact of contingency fees. **Rachel Rothwell** reports

Photograph: Thinkstock

With 'damages-based agreements' (or contingency fees) looming large on the horizon and set for introduction in April 2013, focus has turned to some of the crucial questions that must be answered before they can be brought into force.

Precisely how DBAs will work, and what the consequences could be for law firms, their insurers and clients, was discussed by some of the leading experts in the field (including Lord Justice Jackson himself) at a debate organised by City firm Herbert Smith last month.

The experts considered how to address the dangers of law firm collapse due to over-exposure to DBAs; the extent to which limits should be imposed on the percentage of damages lawyers can take in commercial cases; the impact on the bar; and other issues.

One of the most worrying aspects of DBAs – and one that has received little consideration so far – is the risk they could pose to a law firm's financial stability. Charles Plant, chair of the Solicitors Regulation Authority, drew an analogy with collapsed Manchester firm Halliwells.

'Halliwells had hundreds of millions of over-exposure to property. What about a firm that is over-exposed to DBAs; what if it loses all its cases? ... This is a serious risk,' he said.

**John Kunzler**

Plant said he did not believe that the SRA would need to make any significant changes to its new principles-based code of conduct to tackle DBAs, citing the duties to act with integrity, independence and in the best interests of clients as some of those that will come into play in regulating the use of the agreements.

But he said the regulator needs to 'get stuck in' and make sure it keeps track of firms' exposure to DBAs.

**Leslie Perrin**

'We are regulating 11,000 firms,' he said, 'but there is no reason why we cannot ask them what matters they are conducting on this basis. The starting mechanism will be [identifying] which firms are working under DBAs.'

Plant said the regulator may conduct a thematic review of firms running DBAs to ensure the issue was being looked at in detail. He added that it has powers to go into firms and examine how they are running DBA cases.

But others were less convinced that the SRA alone could provide the protection required.

Herbert Smith's head of dispute resolution Ted Greeno said: 'The SRA cannot possibly look at the quality of the book that a firm has got. Should there then be some form of compulsory safety net insurance for insuring a firm's portfolio against catastrophic loss?'

John Kunzler, senior product manager at Travelers Insurance, added: 'If you are talking about some kind of magic backstop, you are really talking about the compensation fund. The ability to detect law firms taking on these agreements in real time is going to be very difficult.

'I would think the only solution is capital adequacy requirements for law firms. This is one of the issues coming up large in law firms as they become more corporate. For instance, why are they able to distribute the majority of their fees [to partners]? Tidying up the messes that come out of this is going to be a big challenge.'

Third-party funders also want to see capital adequacy requirements brought in for law firms, if only to level the playing field between themselves and solicitors. Calunius' Leslie Perrin said: 'Litigation funders will need to show that they can fund cases for three years under our new voluntary code. But the responsibility of solicitors is to notify the SRA five days after they have gone bust. You might say that's a little unequal.'

**Michael Napier**

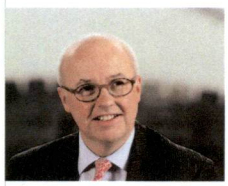
Perrin also highlighted a potential imbalance if, as anticipated, law firms acting under DBAs will not be liable for adverse costs if they lose. Instead, it will be clients (or the third-party funders) who will be in the frame, despite the law firm having effectively funded the litigation through the DBA.

**Lord Justice Jackson**

He said: 'That is the most serious arbitrage point. Funders will come along and collect our practising certificate just to avail ourselves of the protection that solicitors have as of right.'

As a professional indemnity insurer, Kunzler spots another potential problem. 'Unless there are capital adequacy requirements, then I can't see that there is a level playing field. [But] I have concerns that a law firm could be made liable for costs. [The firm may say] we lost because we were negligent, so that it goes through the PI insurer.'

Jackson suggested that a working party should be set up to deal with some of the questions posed by DBAs, to ensure that they are examined 'in appropriate detail'.



**Ted Greeno**

One key question concerns whether to set a limit on the percentage of damages that can be taken by lawyers in commercial cases (DBAs in personal injury will be capped at 25%). Jackson said he had an 'open mind' on whether DBAs should be capped in commercial litigation, but added that he could see 'force' in the argument that experienced corporate clients with their own in-house counsel should be able to reach whatever agreement they wanted with their solicitors.

**Charles Plant**

The judge cited an example of a commercial client that may want to proceed with litigation that had only a 55% chance of success. He said in these circumstances, solicitors may only

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together with a bill of costs totalling nearly £65,000.

The defendant, who was acting in person, applied to set the notice aside on the grounds that there was no authority for it. He relied on part 47.1, which states: 'The general rule is that the costs of any proceedings or any part of the proceedings, are not to be assessed by the detailed assessment procedure until the conclusion of the proceedings, but the court may order them to be assessed immediately.'

The rule is clear enough, and the costs judge considered that he was clearly bound by it. If the judge making the order had not seen fit to order detailed assessment forthwith, it was not for another judge to review that decision. Only the same judge could revisit that decision and vary it.

In practical terms, therefore, strenuous efforts should be made to secure summary assessment at the interlocutory stage or, if this is for some reason not possible, to persuade the judge making the costs order to allow earlier assessment.

**Prodec Networks Ltd. v N2 Check Ltd. [2011] EWHC 90215 (Costs)**

**Key issue** – how a party's costs estimates will influence the costs it can recover.

The claimant won at trial and the defendant was ordered to pay costs.

The base costs in the bill presented to the defendant, after taking out the post-trial costs, amounted to around £135,000. However, there were four costs estimates given during the course of the action.

- At allocation the estimate was £71,000;
- At listing it was still £71,000;
- Less than a fortnight before trial, the costs were said now to be £80,000; and
- Just before the start of the trial, the costs were shown as being still £80,000

So the bill for assessment was some 68% more than the previous highest estimate. Understandably, the defendant argued that the estimates and schedules should be the limit of what the claimant could receive. The costs judge noted that the costs practice direction requires receiving parties to offer an explanation whenever an estimate of costs is exceeded by 20% or more, and that the court may regard a 20% increase 'as evidence that the costs claimed are unreasonable or disproportionate' (costs practice direction 6.6).

The judge was not unduly prescriptive of the sort of explanations which could be put forward. He said: 'I take the view that an explanation for a substantial difference between a bill and an estimate is a "satisfactory explanation" if the court accepts it as a truthful statement which persuades the court that the estimate in question is not a useful yardstick.'

The judge also summarises the issue of reliance by the paying party on the estimates, saying, 'in deciding the effect which reliance upon an estimate should have on the amount of costs to be awarded by the court, the first four factors the court ought to take into account seem to me to be as follows:

1) the extent or degree of reliance;
2) the consequences of that reliance;
3) the explanation, if any, given for any excess of costs over the sum estimated; and
4) the extent to which the estimate has been exceeded.

Thus, for example, taking into account only the first and the fourth of those factors, heavy reliance upon an estimate which was reasonably placed may defeat even a small departure from that estimate. Huge departures from an estimate may not be allowed even if the reliance placed on that estimate was slight or insignificant.' The judgment, then, forms a very useful worked example of just how these factors played out in the context of these estimates and, interestingly, the substantial overspend did not greatly affect the assessment exercise.

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# DBAs under scrutiny

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be prepared to take on the work for a high fee, and there was no reason why the two 'adult parties' should not agree a 55% contingency fee.

The judge said his reforms were intended to 'widen the funding options', adding that 'we must be very cautious before we cut down on those options'.

His remarks appear to indicate a change in thinking from his final report in January 2010, in which he recommended a cap.

Jackson said the working group should also consider what should happen where a client accepts liability for some adverse costs, but will not then pay them; should the solicitor be liable, and if so should this be on Arkin principles?

In relation to third-party funding, the judge said the abolition of recoverability of success fees and after-the-event insurance premiums would 'change the balance very substantially', and there would no longer be a 'huge advantage' in the use of conditional fee agreements over third-party funding. He added that 'there will inevitably be an expansion of third-party funding'.

On the end of recoverability for ATE premiums, Matthew Amey, director of broker TheJudge, predicted that commercial clients will still be prepared to buy the cover as it will remain 'the cheapest way to transfer risk'.

Asked how DBAs might affect the bar, Jackson said he expected to see a 'range of responses', with some sought-after barristers still able to insist on hourly rates (and their fees dealt with as a disbursement which may be met by third-party funders), while others might agree to act on a 'no win, low fee' arrangement.

Solicitor Michael Napier said third-party funders will be the 'cavalry' that will support DBAs by offering funding at an early stage, to enable solicitors to conduct a full investigation of the evidence before potentially moving onto a contingency fee.

Napier predicted a range of 'imaginative' and blended DBA solutions, adding that he believed more US law firms will enter the UK market to take advantage of contingency fees.

But he said that, as personal injury lawyers had discovered, acting under a no win, no fee arrangement would be a very different experience for commercial lawyers. 'As a solicitor, you will be asked to put your money where your mouth is,' he said. 'I am absolutely certain that contingency fees will change commercial litigation, because they are better for the client... They will produce much bigger demand from clients, and solicitors will have to meet it.'