A changing landscape

Peter Sharp examines efforts to retain the Jackson exemption.

With the days of the Jackson exemption apparently numbered, the use of conditional fee agreements (CFAs) by practitioners is set to become less attractive. While CFAs will still remain a possible option, it is a good time to explore the limited experience so far of damage based agreements (DBAs). Are they more attractive as a viable mechanism to enable valuable rights to be pursued? This article seeks to identify lessons learned, and point out the structural, financial and ethical difficulties that have so far inhibited their use.

DBAs: the core components

It is worthwhile revisiting the core components. The central concept is straightforward. Instead of a time-based fee, the lawyer is entitled to a percentage of the amount recovered. There is a cap of 50 per cent. Below that cap, there is no guidance concerning what would be the 'right' level for any particular type of case, whatever its simplicity or difficulty.

Practitioners regularly commission commercial litigation, and will appreciate that time charges, while central to the costing exercise, are by no means the only component. The regulations make no provision, nor could they, for the fees of experts, forensic accountants and others.

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Barristers are now allowed to provide their services on a DBA basis, but that element of expense is not without its problems: a theme that will be revisited later in this article.

Is a DBA right for my case?

So, with a commercial litigation scenario to be pursued, how has the landscape changed for the practitioner looking at their options? There is no doubt that budgetary considerations play a dominant role. In an insolvency scenario, there is of course real cash constraint; the estate has valuable rights, but simply does not have adequate free resources to pursue the claim.

This can particularly be the case in relation to the failure of smaller businesses, which have valuable rights, for example based on anti-trust abuses. The remedies available could transform the outcome for creditors, but the budgets required to take on larger opponents are beyond their reach. For them, the DBA can be a lifeline.

In such scenarios, the willingness of a firm to act on a DBA basis may unlock potentially valuable rights to be pursued. Other factors may bear on the appropriateness of a DBA for any particular case. These can include simplified case monitoring that may be feasible in a DBA scenario. It is no longer of direct concern to the DBA client just how many hours any particular task has taken at the firm. The quality of work is of course of paramount importance, as ever, but the firm now takes the 'risk' that any task will

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take, say, ten hours when it might have taken five. But an important challenge is the impact a DBA relationship may have on the client/solicitor relationship.

The DBA regulations provide no guidance concerning how case strategy decisions are to be taken. Where there is a range of options with varying time and expense implications, how are those choices to be managed when the cost falls on the law firm, not the client? Where a lowish settlement offer is made, but the client might be interested, how is the difficult decision to be made that the strong case for a high value should be 'sold out' for a small proportion?

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Answers to these questions rest with the need for the relationship between practitioner and law firm to be one of transparency and trust, since there are inherent 'conflicts' in these scenarios that are inescapable in a DBA case.

Key areas for reform

The uptake of DBAs in relation to commercial litigation has been very limited. There are several reasons for this. To date, most attention has been paid to the lack of a 'hybrid' option: on a 'pay as you go' basis, the law firm would be remunerated at discounted hourly rates for the work undertaken, supplemented at the end of a successful case by a percentage of the amounts recovered. This is common practice in the United States; however, UK regulations do not permit a hybrid approach. Commentators had expected that a reform could clarify that hybrid structures are permissible, but this was ruled out in a Ministry of Justice statement in November 2014.

The possibility that barristers might now be available on a DBA basis was cited earlier. In practice, however, there may be limited willingness among barristers to embrace the DBA approach. To an extent, this is attributed to concern that the appropriate contractual structure is as yet unclear, and conflict issues integral to a contingency approach left unresolved. This makes it challenging to find the right barrister team for a complex case, on a DBA basis. Meantime, since the rules forbid the firm to charge more than the contingent fee, and wrap the involvement of the barrister team into that, the alternative scenario is for the firm to incur the expense of the barrister team on its own account. For substantial commercial cases, this may be a risk that many law firms are simply unwilling to incur.

This leads us into the problematic area of cost recovery. It is remarkable how challenging this topic has become. Baulking at the notion that an unsuccessful DBA defendant should have to indemnify the claimant in relation to the contingency fee, UK legislators have adopted an approach based on fiction. An unsuccessful defendant in a DBA case will be ordered to pay a hypothetical amount equivalent to the costs that might have been payable, had the claimants' lawyers been working on a conventional time basis.

As a matter of public policy, this may be a tolerable compromise, requiring the defendant to pay something while not punishing them for being unsuccessful at the hands of a DBA claimant. It does, however, mean that the paraphernalia of conventional costs-related activity remains in place in a DBA case, which some might see as an unfortunate inefficiency in the regime.

The difficulty does not stop there. To ensure that the successful firm will not 'over recover' from their client's winnings, the rules require two things: That the 'fictional' fee award should only be recovered from the unsuccessful defendant and no one else, and that the successful claimants' lawyers should be rewarded as regards that amount, only if and to the extent that they are successful in enforcing that costs award.

The bizarre implications of this construct have given the greatest difficulties in working with clients to put in place DBA arrangements in relation to complex cases. They have also dampened the enthusiasm of firms to enter into these arrangements in the first place. For a mid-value commercial dispute, the risk exists that a successful claimant legal team could nevertheless go completely unpaid. To the extent that they are not able to recover the costs award from the unsuccessful defendant, and if the costs on that basis broadly equate to the amount of the contingency fee, there may be no remaining basis on which the claimant is obliged to remunerate their successful lawyers. This in turn leads into difficult issues concerning the allocation of partial payments.

To illustrate this, suppose that the DBA claimant has won a judgment for £5m and that the costs incurred would have totalled (on a conventional basis) £1m. The firm agreed a 30 per cent DBA with their client. Assuming the judgment is satisfied, you would think the firm would be happily expecting to receive a fee of £1.5m, which is a premium over costs on the conventional basis. However, how does this play out if the defendant hands over a lump sum of £3m to the claimant, but is not able to pay a penny more? Thanks to the rules, the successful firm must recover £1m of costs from that defendant. In calculating what they are entitled to recover from their client, they are deemed to have done so. If that £3m payment is all appropriated to the principal amount of the award and not paid in relation to costs, the most the successful firm will be able to earn is £500,000, making a significant loss on its work.

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What does the firm do? Do they try to argue with their client that part of the lump sum payment should be appropriated to costs, so that it can go towards paying the law firm's fee? Nothing in the rules helps us with this conundrum. Faced with the issues identified in this article, practitioners may be despairing of DBAs ever being a useful tool, when assessing a potential claimant action. Meantime, their prospective opponents may be thinking that they have nothing to fear since, in the complex commercial dispute world, it is unlikely they will have to confront such a case. For the DBA to take its place as a useful tool that can be used responsibly in appropriate cases, it is clear that much needs to be done, to turn this innovation from a stumbling prototype into a production model. □

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