



Client Alert
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JACKSON PAVES THE WAY FOR CONTINGENCY FEES

New fee structures part of a package intended to reduce costs

Many clients will have felt the impact of contingency fees (advocates' fees based on a percentage of damages recovered) in judicial systems in the United States. A number of commentators on developments in US litigation have noted that contingency fees there have resulted in major problems surrounding the conduct of cases and the administration of justice.

Insurance and reinsurance market clients may therefore be especially concerned to see that the recent report by Lord Justice Jackson into Civil Litigation Costs advocated the adoption of contingency fees in England and Wales.

The US Experience

In considering the potential effects in the UK of contingency fees, it is useful to consider the key features of the US system. These features include:

- different rules applying between States, with many limiting fees only in cases of medical negligence;
- typical contingency fees in the range of 30% to 40%, depending on resolution being reached before/at trial;
- federal and state court systems, with the latter creating opportunities for local plaintiff attorneys to appear before locally-elected judges and locally-drawn juries;
- juries often setting damages; and
- damages awards being susceptible to multiplication by enhanced (often described as "punitive") damages, which result in awards which can substantially exceed any measure of 'loss' suffered by a claimant.

In contrast, damages under the English system are, in almost all cases affecting the insurance market, decided by judges. Enhanced damages are rare:

- "Aggravated" damages can be awarded to individuals for mental distress in tortious matters, but must be 'compensatory' and not 'exemplary'.
- Exemplary damages can be awarded only in tortious cases to reproach an abuse of power by a government official or where the defendant's action was motivated by the pursuit of profits.

Ontario - A Model System?

The Jackson review looked at contingency fees in a number of jurisdictions outside the US, and the report comments favourably on the system adopted in Ontario, Canada.

The key features of the Ontario system which the report draws on are:

- as in England, "loser pays" is the starting principle;
- the court retains oversight of and control over the amount of and basis for damages; and
- while there may be a measure of liability on the part of an unsuccessful defendant to pay part of the contingency fee incurred by the claimant, this will not exceed the usual costs amount calculated by the court and any remainder not recoverable from the defendant may be payable out of the successful claimant's damages.

The costs awarded against defendants are typically in the region of 15% of damages, while contingency fees are usually around 20%. An average claimant, liable to pay the difference of 5% towards his solicitor's fee,

may therefore retain 95% of his damages.

The UK Experience to Date: "Non-Contentious" Tribunal Proceedings

At present, contingency fee agreements are deployed, with limited regulatory control, in certain non-judicial proceedings such as employment tribunals.

In 2009 the Ministry of Justice announced an intention to regulate contingency fees by, amongst other things, imposing a 25% cap on the percentage of awards which may be charged as fees.

In his report, Jackson LJ recommends that the proposed regulations, including the percentage cap, be adapted for the purpose of court proceedings.

What Might the Future Hold?

Analysis of data obtained by Jackson LJ from the Commercial Court Users Committee, relating to 51 Commercial Court cases in recent years, suggests that:

- recovery rates are typically in the region of 80% of the costs sought;
- average costs claimed to be in the region of £600,000;
- on the basis that 80% of £600,000 is £480,000, a typical claimant might be left to pay £120,000 out of his own pocket;
- although there is no contingency fee, a practical reality is that the benefit for a claimant of a damages award can be significantly reduced by costs payable to his own solicitor which are not recoverable from a defendant.

Assume now that under contingency fee rules:

- a claimant may enter into a contingency fee agreement to limit his obligation to pay his own solicitor's costs to an amount of no more than 25% of a damages award;
- a defendant can only be liable for that portion of a costs claim which a court assesses is 'reasonable' (say, along the lines of current rules on assessment); and
- a claimant will be liable to pay his lawyer any difference between
 - the limit on the contingency fee award, and
 - the defendant's assessed liability for costs.

Assume now that a claimant recovers £500,000 in damages, and incurs £600,000 in costs, of which £480,000 are found to be reasonable:

- the Claimant will be liable to his lawyer for contingency fees of £125,000 (i.e. 25% of £500,000);
- this £125,000 will be recoverable from the defendant;
- the claimant will keep the benefit of the full £500,000 in damages; and
- the claimant's lawyer will be out of pocket on £475,000 of the £600,000 costs incurred.

However, if the same claimant recovers £5,000,000 but the costs are otherwise unchanged:

- he will be liable to his lawyer for 25% of £5,000,000, which is £1,250,000;
- the defendant will pay £480,000 costs; and
- the claimant will therefore retain £4,230,000 of his £5,000,000 damages (i.e. £5,000,000 less £1,250,000 = £3,750,000; £3,750,000 plus £480,000 received from the defendant = £4,230,000).

These figures illustrate how, under contingency fee agreements, the risk of damages being low relative to the costs incurred shifts from the claimant to the solicitor. Claimants' solicitors would be incentivised to keep costs down and advise early settlement where the likely damages are low relative to costs. This could in theory save all parties and the courts time and expense.

The Report also proposes an incentive for defendants to accept formal offers to settle ("Part 36 offers"). If a defendant refuses an offer made by the claimant and damages eventually awarded match or beat that offer, an additional 10% would be added to those damages.

In the preceding example, it would result in

- a damages award of £5,500,000;
- a contingency fee of £1,375,000; and
- the claimant retaining £4,605,000 of his £5,500,000 damages (i.e. £5,500,000 less £1,375,000 = £4,125,000; £4,125,000 plus £480,000 received from the defendant = £4,605,000).

Addressing the Risks

Contingency fee agreements have the potential to raise a host of difficult issues.

Because of the English system of using separate solicitors and advocates (barristers), contingency fees have the potential to present conflicts between the two professions. For instance, if a barrister at trial is professionally negligent so as to cause an otherwise promising claim to fail, the disappointed claimant's solicitors might seek to recover for losses in respect of 'lost' contingency fees. Insurers might therefore wish to consider the extent to which professional indemnity policies would provide cover in respect of contingency fee awards and risks.

Next Steps

The Jackson Review is likely to require new legislation and regulations, which will probably not arise this side of the General Election.

The proposals may however be attractive to any government from 2010 onwards. Hundreds of millions of pounds are spent each year defending claims against tax-funded entities (eg the NHS), and any reduction in the cost of litigation is likely to be welcomed.

Moreover, with a contingency fee, government might find it easier than at present to levy taxes on a substantial proportion of damages which is in effect income for claimants' lawyers.

As well as contingency fees, the Jackson Report produced a wide range of recommendations concerning the funding of civil litigation.

If you would like to know more about these proposals or the issues raised in this alert, please contact:

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