"Improved Access to Justice –

Funding Options & Proportionate Costs"

The Future Funding of Litigation
- Alternative Funding Structures

A Series of Recommendations to the Lord Chancellor
to Improve Access to Justice
through the Development of
Improved Funding Structures

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The Future Funding of Litigation
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INTRODUCTION

1. This paper is the second in a series of papers prepared by the Civil Justice Council under the title "The Future Funding of Litigation – Alternative Funding Structures". It looks in greater detail at Recommendations 10, 11, 13 and 15 contained in the first paper, and is published as **formal advice to the Lord Chancellor**. A list of recommendations from the first paper appears at **Appendix 1**.

2. The background to the Civil Justice Council's history in costs and funding reform is laid out in the introductory paragraphs of the first paper

3. The Civil Justice Council consulted on the 21 recommendations contained in its first report at its annual Costs Forum, held in February 2006 before a representative group of around eighty stakeholders (a list of organisations represented at the Costs Forum appears at **Appendix 2)**.

4. With the exception of Recommendation 7 (Costs Budgeting[1]), the Forum supported the recommendations by overwhelming majority, and invited the Civil Justice Council to conduct further detailed consideration, and to prepare formal advice to Government.

[1] Recommendation 7 proposed a rebuttable presumption that there would be costs budgets in cases valued at over £1m

5. Following stakeholder ratification, the Master of the Rolls commissioned members of the Costs Committee, in conjunction with representatives of the Legal Services Commission, to consider in more detail recommendations 10, 11, 13 and 15 relating to (i) the possible establishment of a contingency legal aid fund (ii) the possible introduction of contingency fees in contentious civil business (iii) the possible opportunities to develop third party funding and (iv) the possible particular relevance of these methods in the funding of group actions.

6. Shortly thereafter, Lord Carter's report "Legal Aid – A market based approach to reform" contained (at annex 3.1) a further commission for the Civil Justice Council, Legal Services Commission, and [the then] Department for Constitutional Affairs to explore further options for a contingent legal aid fund.

7. The Civil Justice Council with the support of the Legal Services Commission engaged in a detailed comparative study of Contingency Legal Aid Funds, Supplemental Legal Aid Schemes, and the operation of Third Party Funding in Hong Kong, Australia, and Canada.

8. The study group held meetings with key senior figures in these jurisdictions including Judges, Academics, Government Officials, Legal Service providers, practitioners and Commercial Legal Funding Organisations. (A list of attendees of those meetings appears at **Appendix 3)**.

9. The study group reviewed a considerable volume of research material from the jurisdictions studied, and also wider jurisdictions. (A non-exhaustive list of material reviewed appears at **Appendix 4)**.

Following the study, CJC thinking in relation to the funding of multi party claims for consumer redress was tested at a stakeholder event held in November 2006. All recommendations were then discussed before a representative group of around ninety stakeholders at the CJC Costs Forum held in February 2007 (a list of organisations represented at the Costs Forum appears at **Appendix 5)**.

10. The Civil Justice Council remains committed to the overriding principles published in the first report[2]. These principles state that 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.

11. It is with these principles as a guide that the Civil Justice Council makes its further recommendations in this second report. For a review of the current methods of funding civil cases in England and Wales see **Appendix 6**.

[2] These principles were also ratified by the Costs Forum in 2006

12. The Civil Justice Council is grateful for the continuing support of the Legal Services Commission in the work of the Study Group. However, and for the avoidance of doubt, the recommendations contained in this report are recommendations of the Civil Justice Council alone.

13. The Civil Justice Council **invites the Lord Chancellor to respond formally**.

PART 1

EXECUTIVE SUMMARY

KEY ASSUMPTIONS, FINDINGS and RECOMMENDATIONS

KEY ASSUMPTIONS

Key Assumption 1 -

There will be no new Government money to fund the Recommendations

14. This paper is written on the assumption that the Government will not provide any additional public money either to increase legal aid coverage in civil, or to provide any seedcorn funding to "pump prime" a Contingency Legal Aid Fund or Supplemental Legal Aid Scheme.

Key Assumption 2 –

The concept of "No Win, No Fee" is now ingrained in the funding system

15. This paper accepts that it is current Government policy to continue to support the funding mechanism of Conditional Fee Agreements in their current form, and is written on the assumption that Government has no immediate plans to change this policy.

16. In the absence of Legal Aid for much of civil process, no win, no fee agreements do provide access to justice. However, the current operation of Conditional Fee Agreements, backed by after the event insurance (ATE) is dependent on the sustainability of an insurance market that is perceived as fragile, and is beset with complexity causing additional cost and uncertainty. (For recent case law see **Appendix 7**).

KEY FINDINGS

Key Finding 1 –

None of the alternative funding schemes that have been studied[3] in other jurisdictions would operate effectively in England and Wales.

17. Most schemes operate at very low volumes (no more than 100-120 cases per year, some significantly less), and the majority of their business is in lower value, low risk litigation. Most do not offer any significant form of cost protection.

Key Finding 2 –

None of the studied schemes would be immune from the problem of adverse selection against other funding mechanisms in England and Wales.

18. The majority of schemes operate effectively because of a lack of alternative options. Where alternatives have emerged, the effectiveness of the schemes studied is diminished

[3] Schemes studied: Hong Kong CLAF, SLAS and CLAF schemes in all Australian states, Ontario Class Action Fund, general funding of multi party consumer actions in Vancouver, Quebec Fonds Collectifs

RECOMMENDATIONS

Recommendation 1

A Contingency Legal Aid Fund (CLAF) should not be established under the current cost regime of England and Wales.

19. Although there is considerable merit in the concept of a CLAF, there is insufficient evidence from other jurisdictions that a CLAF style scheme could be transported to this jurisdiction. CLAF's can be successful, but suffer variously from insufficient seed funding, adverse selection, and (even where successful) expansion into higher risk (losing) cases that reduce income and threaten the scheme. It is unlikely that a CLAF would be successful in England and Wales due to adverse selection in a system where conditional fee agreements are operating successfully.

Recommendation 2

A Supplementary Legal Aid Scheme (SLAS) should be established and operated by the Legal Services Commission.

20. A SLAS would expand access to justice by increasing legal aid coverage and good value for money by (i) creating additional funds and (ii) reducing the net cost of the scheme. The SLAS would introduce a form of self-funding mechanism into the legal aid scheme whereby, if a case was won, costs would be recovered and an additional sum would be payable to the fund by means of a levy to be paid as a percentage of damages recovered, or out of recovered costs. The SLAS would offer protection to parties from adverse costs if a case is lost. Positive recovery via the levy could be used to expand public funding for the civil legal aid budget. Also, the SLAS scheme could be engineered to link with Conditional Fee Agreements as a complementary method of funding via a levy on costs/damages recovered.

Recommendation 3

Properly regulated Third Party Funding should be recognised as an acceptable option for mainstream litigation. Rules of Court should also be developed to ensure effective controls over the conduct of litigation where third parties provide the funding.

21. Third party funding is already established in England and Wales. The case of *Arkin* laid down principles for third parties to fund cases and defined to what extent third party funders may be liable for costs in cases that are lost.

22. The decision of the High Court in the case of *Fostif* in Australia (where Third Party Funding has been established for more than a decade) undertook a modern review of the notions of champerty and maintenance. The Court provided guidelines on the role and limits of third party funder influence on the conduct of litigation and the relationships between third party funders, lawyers and their clients.

23. Third party funding has the potential to increase access to justice in areas of consumer rights and multi party action. However it must be effectively regulated and rigorously controlled by the courts.

Recommendation 4

In multi party cases where no other form of funding is available, regulated contingency fees should be permitted to provide access to justice. The Ministry of Justice should conduct thorough research to ascertain whether contingency fees can improve access to justice in the resolution of civil disputes generally.

24. Contingency fees, subject to proper court control may now be an essential method of funding multi party cases where legal aid and/or no other from of funding is available.

25. However, this paper does not recommend the blanket introduction of contingency fees in contentious business.

PART 2

RECOMMENDATIONS

Chapter A - SELF FUNDING SYSTEMS

26. Recommendation 10 of the Civil Justice Council's August 2005 Report proposed that further consideration be given to (i) the Conditional Legal Aid Scheme (COLAS[4]) previously proposed by the Law Society (ii) the Contingency Legal Aid Fund (CLAF[5]) previously proposed by the Bar Council and Justice, and the Supplementary Legal Aid Scheme (SLAS) operating in Hong Kong.

27. The common feature of these schemes is that a funding system can be sustainable if it claws back from successful actions a levy, akin to a contingency fee as understood in the USA & Canada. Ideally the net gain to the Fund from successful cases should cancel out the net loss of losing cases. All the models rely to some extent on attracting the right range of cases through an effective merits filter.

28. The archetypal CLAF is a free-standing fund fuelled by a levy on damages recovered by successful participating cases. A SLAS differs in that it is not a stand alone scheme but is an additional feature of an existing Legal Aid Scheme. The fundamental difference between a CLAF and a SLAS is that a CLAF is an

[4] A proposal by the Law Society to link legal aid and conditional fees (December 1997)
[5] Justice proposals for Contingency Legal Aid Fund (1978) and also Bar Council "CLAF – an idea whose time has come" (August 1997) and Consumer Association policy paper Contingency Legal Aid Fund (November 1997).

independent commercially run (not necessarily for profit) scheme whereas a SLAS is operated by an existing Legal Aid Scheme. The Conditional Legal Aid Scheme proposed by the Law Society (COLAF) would involve a combination of CLAF/SLAS mechanisms in conjunction with CFAs. How this might work with a SLAS is considered in Chapter B of this report.

29. Any contingency funding model can only succeed if it can attract the right case mix and avoid the problems of adverse selection if it has to compete with other funding mechanisms that attract 'easier' cases. This paper has drawn on the studied experience of contingent style funding schemes in other jurisdictions.

The Hong Kong Scheme

30. The SLAS is administered by the Hong Kong Legal Aid Board operating similar procedures and merits criteria to their main legal aid scheme. Applicants for support from the SLAS are required to pass a financial eligibility test, which extends to a higher level of income than for the main legal aid scheme. It is therefore more generous in extending to a broader section of the population. In successful cases the SLAS receives a payback from damages of 6% on awards settled before trial and 10% of cases to trial, in addition to the costs that are recovered from the unsuccessful party and paid back to the fund.

31. The SLAS was pump primed with a 1 million Hong Kong Dollar (HKD) loan from the Jockey Club which is the local lottery fund. The loan was not fully utilised and to the extent that borrowing was taken up, it has been repaid with interest. The SLAS fund has grown to nearly 90 million HKDs and has been running profitably for many years, covering both its fund expenditure and administration costs through the levy on successful cases. However, the profitability of the scheme has reduced since 1989 when the scheme was expanded from covering only main stream (road traffic) personal injury cases to include employers' liability, clinical, dental and professional negligence cases.

32. The protection from adverse costs for a legally aided litigant in England and Wales does not apply in Hong Kong. Instead the SLAS is responsible for paying the costs of the successful opponents of a legally aided litigant. This necessarily leads to a cautious approach by the Hong Kong Legal Aid Board in assessing the merits of cases, particularly the more difficult employers' liability, clinical, dental and professional negligence cases.

33. There is an increasing trend in Hong Kong, as in other parts of the world, for road traffic personal injury cases to be captured by non lawyer claims managers thus depriving the SLAS of the essential cohort of 'easier' cases that allow the fund to operate on the basis that the many have to pay for the few. Further, the SLAS has always operated on quite low volumes of cases that are declining significantly. The number of cases covered by the SLAS in the last six years are as follows:

Breakdown of categories of cases granted under SLAS

Year	Case code							Total
	SDN	SEC	SMN	SPI	SPN	SRD	SSA	
2000	1	80	9	68	1	45	0	**204**
2001	0	71	6	60	1	20	1	**159**
2002	0	53	4	45	1	20	1	**124**
2003	1	28	6	35	1	8	0	**79**
2004	1	39	1	36	1	7	0	**85**
2005	1	30	4	38	2	10	0	**85**

Code description:

SDN - SLAS Dental Negligence
SEC - SLAS Employees' Compensation
SMN - SLAS Medical Negligence
SPI - SLAS Personal Injuries
SPN - SLAS Professional Negligence
SRD - SLAS Running Down
SSA - SLAS Sea & Air Collision

34. A strong question mark therefore hangs over the long term profitability of the SLAS in Hong Kong even though it does not have to compete with CFA's that are not available there. The Law Reform Commission of Hong Kong is considering a new funding model (called a CLAF) that would require the legitimising of conditional fee agreements (in limited circumstances) linked to the SLAS with a levy repaid to the SLAS. (Similar to the Law Society COLAF model). An extract from the Law Reform Commission of Hong Kong Consultation paper reads as follows:

"Consideration should be given to setting up an independent body to screen applications for the use of event triggered fees to brief out cases to private lawyers, to finance the litigation and to pay the opponents legal costs should the litigation prove unsuccessful. Applicants under the scheme would not be means tested but applications would have to satisfy the merits test. The proposed body would take a share of the compensation recovered, while the private lawyers would be paid on a conditional fee basis. Litigants with a good case would therefore have access to the courts without financial exposure, even if ATE insurance was not available and SLAS was not expanded"…

The Ontario Scheme

35. A Class Proceedings Fund established with a seed grant of ½ million Canadian dollars from the Ontario Law Foundation assists the financing of disbursements (only) in class actions. This fund has a contingency element because it claims back a 10% levy on awards and settlements in successful cases. It is administered by a committee of the Law Foundation which considers the merits and public interest aspects of a potential class action in deciding whether funding will be granted. Funding is granted in stages as the action progresses with the support of legal opinion to certify the merits. The fund is responsible for opponents' costs in unsuccessful cases.

36. Although the Ontario fund appears to be viable, the volume of applications is low (possibly influenced by the fact that funding is restricted to disbursements) and only a handful of new applications are considered each year. In 2005 the total awards amounted to only 288,000 Canadian dollars. The Ontario fund must also be seen in the context of the funding regime in Ontario where contingency fees (court controlled) are the primary funding mechanism for group actions.

The Quebec Fonds Collectifs

37. The longest established and perhaps most innovative contingency style funding system is found in Quebec, and is available for group actions. The Fonds D'Aide aux Recours Collectifs (The Fonds) is a form of subsidised CLAF to support class actions. The Fonds is administered separately from but is complementary to the fairly comprehensive legal aid scheme in Quebec.

38. The Fonds was started in 1978 with limited public seed funding and took several years to justify its running costs. Gradually over the years the Fonds has expanded and become more profitable. Although it has been working very well for many years the Fonds is vulnerable, as with all group action funding systems, so the risk that losing even a small number of expensive large actions will jeopardise the longer term sustainability of the fund.

39. Over 800 applications to certify class actions have been received in Quebec, more than any other province. Class actions are subject to tight judicial control. The Judge who authorises the action makes a prima facie assessment of the merits and defines the class in an opt-out system under which the Court has wide powers to award global damages. There is no right for claimants outside the defined class to bring a separate claim.

40. The Fonds supports a wide range of class actions including product liability, environmental claims and consumer matters. Administration of the Fonds includes an interview of all potential applicants. Where an application for

funding is refused on the merits there is a right of appeal to the Court. Where funding is approved an “administrative agreement” is entered into which fixes the remuneration regime for the action as it proceeds and defines the extent of the right of the Fonds to make a claim on damages awarded (usually referred to as a right to subrogation). The Fonds is not a fully self-financing CLAF but is 50% subsidised by the Government of Quebec, the other 50% coming from levies on damages in successful cases.

41. In a case supported by the Fonds the claimant lawyers receive payments on account as the claim progresses and further remuneration if the action is unsuccessful. However, the hourly rate is limited to 100 Canadian dollars per hour, (roughly £45-50 per hour) which is not regarded as profitable for complex cases. The incentive for claimant lawyers to pursue cases to a successful conclusion resulting in higher remuneration is similar to the differential rates that apply to certain publicly funded high cost civil cases in England and Wales (eg clinical negligence).

42. If a Fonds supported class action is pursued to a successful conclusion:

- The lawyer recovers between the parties costs but at a very limited rate.

- The lawyer receives a contingency fee from the total award of damages. The level of this fee is regulated by the Court, typically at 15% or 20% with a maximum of 25%.

- Out of the contingency fee recovered the lawyer fully reimburses the Fonds for all funding on account provided during the case.

- The Fonds also has a right of subrogation either to a share of the damages awarded to the individual client (up to 10%) or a larger share of any unclaimed global award that could be as high as 50% or 70% of unclaimed damages. (Damages may be unclaimed because the class action originally declared as ‘opt out’ has a residue of damages that exceeds the number of claimants who where later invited to ‘opt in’).

43. Whilst the Fonds is an extremely interesting funding mechanism especially in consumer redress class action cases it is hard to envisage it being replicated in England & Wales in the absence of a contingency fee system and an improved procedural system for customer redress claims.

CLAF style schemes in Australia

44. CLAF style schemes exist in many Australian states (see **Appendix 8**) including South Australia, Tasmania, Western Australia, Victoria and Northern Territory. Although they appear to be effective the volumes of disputes funded is very low. Further, the Western Australian Litigation Assistance Fund, established in 1991 with 1 million Australian dollars seed funding, was closed in August 2003.

45. Each Australian CLAF style scheme has its own scope and procedures: South Australia operates two separate schemes, one for costs generally, the other limited to disbursement funding only. Both schemes require a non-refundable application fee of 100 dollars or 250 dollars where urgency is an issue. In a successful case the scheme claws back 15% of the award plus reimbursement of its outlay. The disbursement only fund recovers a levy related to the extent of disbursement funding provided. Similar rules apply to the schemes in Tasmania, Victoria and the Northern Territory although detailed analysis is not useful because the volume of cases supported is very low. The success of the Australian schemes that continue to be viable may be due to the limited number of applications made.

46. The Australian schemes do not accept responsibility for the other side's costs, nor is anything akin to legal aid cost protection available. Therefore, litigants who apply to such schemes remain personally liable for adverse costs.

Northern Ireland

47. The idea of a CLAF or SLAS style scheme has been considered in Northern Ireland for a number of years. The Northern Ireland context is interesting because the underlying costs jurisdiction is similar to England and Wales, but conditional fee agreements have not been introduced and legal aid is still available for personal injury claims. The Access to Justice (Northern Ireland) Order 2003[6] contains similar provisions to the Access to Justice Act 1999 applicable in England and Wales but has only been introduced in stages. Options for the funding of money damages claims remain under review in Northern Ireland where a wider range of choice may be available in the absence of conditional fees and the ensuing adverse selection problems that are a major challenge to self funding CLAF style schemes in England and Wales.

48. In July 2001 the Legal Service Research Centre published a study into the viability of a CLAF or SLAS scheme in Northern Ireland.[7] The study was based primarily on analysis of the profiles of damages claims funded by legal aid and concluded that based on the outputs from the statistical model used a CLAF scheme recovering costs from a levy on damages or costs could operate on a self-sufficient basis. Provided the scheme involved a moderate case registration fee, it could be established with minimal seed funding. However, the report acknowledged a number of risks and assumptions that could affect the viability of the scheme. Effective merits testing and monitoring of outcomes would be necessary and higher risk case categories should be excluded from the scheme, at least initially.

49. Further studies and analysis have taken place and are continuing. In 2002 a study by Deloite & Touche[8] considered the viability of a CLAF mechanism on the assumption that the CLAF would not be protected from liability to pay other side

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[6] SI 2003 No.435 (N.I.10).
[7] Report of the feasibility of a CLAF scheme for Northern Ireland, LSRC, July 2001.
[8] Review of the Operation of Litigation Funding Agreements in Northern Ireland, Deloite & Touche, November 2002.

costs in unsuccessful cases. The study suggested that in those circumstances a CLAF mechanism was unlikely to be viable or would require a substantial levy on damages in excess of 20%. The study again emphasised the importance of effective merits screening to viability of the system.

50. The Legal Services Commission Northern Ireland has recently consulted on introducing a Funding Code along similar lines to the code operating in England & Wales[9]. Such a Code would impose a greater discipline on money damages cases within the existing scope of legal aid. This could create the right environment in which a SLAS system could be established based on legal aid procedures and merits screening whilst presumably retaining legal aid costs protection. This and other options remain under review.

Could a CLAF work in England and Wales?

51. Study of CLAF and SLAS schemes in other countries has shown that the success or failure of a scheme is dependent on the legal environment in which it operates. The extent of competition from other methods of funding and the low volumes of the schemes studied suggest that although there is much to learn from other jurisdictions, no individual scheme we have studied would be directly transportable to England and Wales.

52. If the design of a CLAF scheme were to be based on self funding fuelled primarily by personal injury claims, self evidently such a scheme would have to compete with the now established CFA market, so long as that market continues to be supported by a strong ATE market. The problem of adverse selection due to the bulk of personal injury cases being handled by CFA appears to be an insurmountable hurdle for the establishment of a CLAF scheme, and a challenge to the viability of a SLAS.

[9] The Northern Ireland Funding Code, NILSC, November 2006.

53. In addition to adverse selection, the problems of seed funding and exposure to other side's costs in losing cases pose major problems for a CLAF. Seed funding is essential; many foreign schemes started with limited funding and built up gradually over many years. Potential sources of seed funding are public funds, commercial litigation funders, other financial lenders and charity/lottery funds. It is clear that there is no room to seek public funds from the Treasury (Key Assumption 1). It is also clear that commercial litigation funders have no interest in contributing to a funding pool that would be allocated by others when assessing which cases to support. The likelihood of commercial lenders or charitable sources committing funds to pump prime a CLAF is equally remote.

54. Even if a credible business model could be advanced to demonstrate that for a given category of case a CLAF could be profitable enough to cover its expenditure and repay seed funding it seems highly unlikely that a model could overcome the adverse selection risks already referred to. Adverse selection is the key problem. As long as it exists a CLAF may be attractive in theory but unworkable in practice.

55. The viability of a CLAF might be improved by use of the mechanism under section 28 of the Access to Justice Act 1999 that allows Rules of Court to make the profit element of a litigation funding agreement (CLAF) recoverable from the other side, in the same manner as the success fee and insurance premium where a CFA is used. However, any attempt to introduce a CLAF scheme that recovered its payback by a success fee recoverable from opponents would be certain to generate a further "costs war" involving satellite mitigation.

56. The responsibility to meet costs of the other side is another major impediment to the viability of a CLAF. CLAF schemes that in Australia do not provide protection against other side costs orders partially explains the low volume of cases they support. In England & Wales the only area of costs protection is for

cases funded by legal aid. Unless or until there is a major derogation from the principle of costs shifting through legislation a CLAF will always be vulnerable to erosion of costs having to be paid out in losing cases.

Summary

57. There is no realistic prospect of a free-standing CLAF or even a CLAF style scheme being viable for the support of civil disputes in the context of the present funding system in England and Wales. The principle reason for this conclusion is the inherent inability of a CLAF to compete effectively with now well established CFAs. If the current CFA/ATE mechanism were to deteriorate significantly the situation would be entirely different and a CLAF approach might need to be reconsidered along with all other funding options, including contingency fees.

58. The difficulties identified with a CLAF mechanism are substantially reduced when one considers the option of a SLAS (Recommendation 2).

59. A table showing the main features of CLAF and SLAS schemes in other jurisdictions studied appears at **Appendix 8.**

Chapter B - A SUPPLEMENTARY LEGAL AID SCHEME (SLAS)

Recommendation 2 - A Supplemental Legal Aid Scheme (SLAS) should be established and operated by the Legal Services Commission.

Options for a SLAS for England and Wales

60. This part of the report looks at the various ways in which a SLAS could be set up in England and Wales based on the existing Legal Aid Scheme. All models considered are therefore based on categories of case currently within the scope of legal aid funding, of which group actions is the main focus. However, the SLAS approach can also be considered for individual damages claims such as clinical negligence, actions against the police, education damages or housing disrepair. Each subject area raises its own issues which may require further analysis and consultation beyond the scope of this report.

Advantages of a SLAS over a CLAF

61. Some of the problems with setting up a CLAF in England and Wales discussed in the previous chapter are reduced or overcome entirely with a SLAS model:-

    (a) A SLAS has no need for seed funding. If a SLAS mechanism is introduced for cases funded after a certain date, it may take years

for cases to start to bring in a profit and for the Scheme to be fully or partially self-financing. In effect the Legal Aid Scheme for such cases would evolve over time into a fully operational SLAS without the need for cash injection from day one.

(b) A SLAS is less vulnerable to adverse selection than a CLAF. This is partly because we envisage a SLAS operating in categories of case where CFAs are less dominant than in mainstream personal injury litigation. More fundamentally, however, certain varieties of SLAS can survive having some strong cases diverted to CFAs because a SLAS does not have to be 100% self-financing. However, the more self-financing a SLAS is, the greater the potential there is to expand access to justice by extending a SLAS to cover cases which would not be funded under the existing Legal Aid Scheme.

(c) A SLAS does not necessarily need to be viable year on year. As part of a wider fund the profitability of a SLAS may vary from one year to another without necessarily jeopardising its continuation.

(d) Only a SLAS has the option of incorporating statutory legal aid cost protection which is restricted under the Access to Justice Act 1999 to cases funded as part of the Community Legal Service.

(e) There are significant administrative savings for a SLAS administered by legal aid authorities compared to a separately administered CLAF. The Hong Kong scheme, whilst administered by the legal aid authority, records its administrative costs separately. These are fully covered by the SLAS levy.

(f) Under the Hong Kong model the SLAS mechanism is applied only for a range of clients who are eligible for SLAS but above the limits for the basic Legal Aid Scheme. Under that model the band of cases covered by SLAS needs to be fully self-funding. An alternative approach is for a SLAS mechanism to apply to all clients, including those who would in any event be eligible for legal aid. That could be a simpler system overall with all clients on the same footing, although it would be argued that those clients towards the top end of the eligibility range were being subsidised by those at the bottom.

Potential to expand access to justice

62. There are two options for the introduction of a SLAS mechanism:

(a) To include only cases which are within the existing scope of legal aid, thereby reducing the net cost of the Scheme. This appears to be the thrust of the recommendation in annex 3.1 of Lord Carter's report.

(b) To expand access to justice by making a SLAS mechanism also available to clients currently outside the existing Legal Aid Scheme, particularly those in the "sandwich class" of clients who are somewhat above legal aid eligibility limits.

63. Both these forms of a SLAS should be kept open for consideration and financial analysis. Restricting a SLAS mechanism only to clients newly brought into the scheme is attractive in preserving existing client rights but would place a heavy burden on a limited sandwich class. By contrast the size of any necessary levy on damages or costs is likely to be several times smaller if spread across the full eligible population.

64. A SLAS could allow access to justice to be expanded through any combination of extended financial eligibility or relaxation of merits criteria. Although it is sometimes said that the LSC can be too strict or bureaucratic in its application of the merits criteria for group actions, we have not considered the merits criteria save to comment that any relaxation of the criteria would jeopardise the viability of a SLAS.

65. However, the existence of a SLAS would impact on the application of one of the most controversial merits criteria, the affordability test that (at 6.4 of the LSC's Funding Code) allows funding to be deferred or refused where it is not affordable out of the budget set by the Lord Chancellor for very high cost cases. The prospect of a levy bringing funds back in at the conclusion of the case may result over time in more actions being affordable from the limited budget for very high cost cases.

66. It is, therefore, the possibility of using the SLAS mechanism to widen financial eligibility limits for legal aid that has the greatest potential to extend access to justice. Indeed, one of the access to justice gaps is the funding problems of clients who are above legal aid eligibility but who do not have effective access to other funding mechanisms. However, since it is a key assumption in this report that no new public money will be available to implement its recommendations, it follows that the Legal Aid Scheme as a whole must be no more expensive when a SLAS is in place than the present scheme.

67. If a SLAS could be 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, no matter how much detailed financial modelling is undertaken, there will always be uncertainty as to how a SLAS will operate until it is in place. In particular the extent of the impact of any adverse selection due to CFAs will be difficult to predict accurately. 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.

68. A more measured approach to implementing a SLAS may therefore be called for. One could start simply from option (i) above, applying the system to existing funded cases, and deciding how to extend it in the light of experience. Or minor eligibility extensions could be made at the outset and kept under review, hopefully to be expanded over time. Extensions of eligibility can take the form of a general raising of income or capital limits for a particular category, or the introduction of a discretion to waive income or capital eligibility limits for clients outside the usual scheme. The use of a waiver power, which could initially be introduced on a limited or pilot basis, would have the advantage of preserving the uniform eligibility rates across all the categories which were introduced as part of the 2005 New Focus Legal Aid Reforms.

Legal Aid Provision and Damages Recovery

69. Civil legal aid under the Access to Justice Act 1999 is available subject to:-

    (a) The exclusions from scope in Schedule 2 of the 1999 Act as modified by directions from the Lord Chancellor bringing cases back into scope.

    (b) Financial eligibility limits on disposable income, gross income and disposable capital which are laid down in regulations made under the 1999 Act. There are limited powers to waive eligibility limits, most notably in group actions with a public interest where funding is restricted only to certain issues.

(c) Merits criteria set out in the LSC's Funding Code which cover matters such as prospects of success, cost benefit, alternative funding and affordability.

70. Where public funding is granted, remuneration is provided during the course of litigation and at the end, insofar as costs are not recovered from the other side. However, remuneration for non-family litigation is at rates prescribed in the LSC's contracts and certain regulations that are far below the hourly rates recoverable for successful litigation on a between-the-parties basis. Potentially high cost cases (those likely to cost the Fund £25,000 or more) are subject to strict controls through the LSC's Special Cases Unit. There are individual contracts based on case plans for the running of the litigation with remuneration at restrictive "risk rates" to incentivise cases further to be brought to a successful conclusion. Payments on account are available in publicly funded cases including payment for all reasonable disbursements.

71. In most successful individual non-family cases, costs are recovered in full at the end of the case. This allows the LSC to recoup all payments on account made and for the client to retain 100% of their damages. However, if there is a shortfall between the costs recovered from the other side and the costs paid from the Fund, that shortfall is taken out of the damages recovered through the operation of the legal aid statutory charge which arises under section 10(7) of the 1999 Act.

72. One of the features of the Legal Aid Scheme when it was first established in 1950 was that payment of profit costs and counsels' fees under a legal aid certificate were subject to a 15% deduction, subsequently reduced to 10%. This deduction applied to net payments from the Fund, which in those days were calculated at normal inter partes rates rather than prescribed rates. In addition, in successful cases where costs were recovered in full from the opponent, the legal aid solicitor would have to pay 10% of the recovered inter partes costs back into the Fund. In

effect the old Legal Aid Scheme was 10% pro bono. In this way the scheme operated as a SLAS in that the Legal Aid Fund made a net gain in successful cases. This system was abolished by the Legal Aid Act 1988.

73. By contrast in the modern scheme it is a feature of group litigation in particular, as recognised in the Carter Report, that even when actions are substantially successful on the issues, the Legal Aid Fund is often left with a significant irrecoverable expenditure. Costs relating to individual unsuccessful claimants are irrecoverable and it is within the discretion of the Court not to order full recovery of generic costs where many of the individual claims have failed. Such a net liability may be exacerbated if the Court adopts an approach of issues-based costs orders, rather than recovery of generic costs as a whole following the generic event. In addition, any costs incurred by the Legal Aid Fund in any cost assessment proceedings are by regulation exempt from the statutory charge.

74. All these instances of a net liability on the Fund, even when a case is successful, would need to be mitigated or removed before a SLAS mechanism could be set up allowing the Fund to make a net profit in successful cases, particularly group actions.

75. Where a case supported by legal aid is unsuccessful, the Legal Aid Fund will remain liable for payment of claimant costs at legal aid prescribed rates, subject to the cost assessment of what is reasonable and any cost limitations on the certificate or contract. The Legal Aid Fund has no general liability for other side costs. For first instance costs the Fund is only liable if the opponent is an individual who will suffer severe financial hardship unless an order is made. Therefore, liability of the Fund for other side costs is essentially limited to appeal cases.

76. Where a case is unsuccessful the Court will generally make a costs order against the funded client in exactly the same circumstances as if the case had not been funded, but the liability of the client to pay those costs is severely restricted by

statutory legal aid costs protection. Since potential liability for other side costs is an obvious deterrent to access to justice, legal aid cost protection is a fundamental aspect of the scheme.

77. Cost protection is provided for under section 11 of the Access to Justice Act 1999 and the Civil Legal Aid (Costs Protection) Regulations 2000. Essentially a funded client is only liable for any costs order to the extent that the Court considers it reasonable in all the circumstances including his or her financial resources. Since the process of determining what is reasonable for the client to pay will itself involve the opponent in incurring further costs and, since by definition the funded client who has been found financially eligible will have limited assets, it is very rare for any part or any costs order to be enforced against a funded client.

78. However, if financial eligibility were expanded significantly as part of a SLAS system, for clients with more substantial financial resources, the prospect of opponents enforcing orders would increase. Regulations can be made under the Act to restrict the scope of costs protection, to 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.

79. Although this report does not include detailed financial modeling which would be necessary before any SLAS scheme were introduced, it is useful to set out in broad terms the level of expenditure of public funding in different non-family areas and the broad level of damages recovered as a result of that funding. Ultimately the objective of a SLAS model is for some or all of the net cost of the scheme to be covered by a levy either on damages or costs, or both.

80. The LSC currently funds major group actions out of a budget of £3 million per annum, which potentially limits the scope of major new group litigation.

81. LSC reporting systems do not always record the level of damages recovered in successful cases, but do record net costs and the level of inter partes recovery. By way of illustration, the table below sets out the net costs of the Legal Aid Scheme (taking account of all recoveries) and the level of inter partes recovery in the areas of Clinical Negligence claims and Actions Against the Police (including other damages claims against public authorities such as Child Abuse).

05/06	**Net Cost to the Fund**	**Level of Inter Partes Costs Recovery**
Clinical Negligence 05/06	£28.5 million	£66 million
Actions Against the Police 05/06	£4.2 million	£4.3 million

82. In terms of damages recovery figures from the NHS Litigation Authority are a good illustration for Clinical Negligence claims. Total damages payments by the NHSLA for 05/06 were over £591 million. Total legal costs, both claimant and defence for claims closed in that year are just over £145 million. The majority of NHSLA payments therefore relate to damages. Whilst a significant minority of damages claims concern cases funded other than through legal aid, legal aid costs also result in recoveries from other sources such as the Medical Defence Union. Overall the level of damages recovery in legal aid Clinical Negligence claims is very substantial and is likely to be more than ten times the net cost of the scheme to the Legal Aid Fund.

Relating a SLAS to CFAs and Other Funding Sources

83. If a SLAS system were set up in England and Wales it would not operate in a vacuum. It is therefore necessary to consider the potential inter-relationship of a SLAS with other mechanisms, in particular CFAs.

84. At present legal aid can be refused for certain categories of case on the basis that the case is suitable for a CFA. This power is not available in clinical negligence proceedings or claims against public authorities alleging serious wrong doing, but is available for all group actions and miscellaneous damages areas such as contract and education damages claims. This relationship between legal aid and CFAs is governed by the Funding Code Criteria which can, of course, be amended subject to affirmative Parliamentary approval.

85. Since one of the principal objectives of a SLAS is to extend access to justice by making alternatives available where none exists at present, it is perhaps logical that there should be no obligation to provide SLAS funding in cases where CFAs already provide an effective access to justice mechanism in themselves. This inter-relationship could work in a number of ways:

   (a) SLAS funding would be refused where CFAs and ATE were viable and available for the totality of the costs.

   (b) SLAS funding may have a particularly important role at the early investigative stage of a case. There could therefore be a role for SLAS funding to be used to work up a case to a point from which it could proceed thereafter entirely through private or CFA funding. The right of SLAS to recover its profit element at the end of the case would, of course, need to apply even if SLAS funding was not provided throughout the life of the case.

(c) A more gradual approach could also be adopted. For example, from a certain point in a case SLAS funding could be restricted to disbursements only.

(d) SLAS funding and CFAs could also co-exist for different elements of a case. In group actions the LSC's existing guidance recognises that legal aid should usually be concentrated on running the generic issues in the case leaving all individual costs, other than pursuing the test or lead cases, to be covered by CFAs.

86. None of the options for SLAS considered below exclude these combinations of consecutive or concurrent funding through CFAs.

87. Similarly, SLAS options do not exclude the possibility of combined or partnership funding from other sources, such as trade union funding, or NGOs. There would under such arrangement need to be clear agreement reached at the start of such a case as to the rights and responsibilities of each funder to any damages or costs recovered. Often the greatest advantage of other funders working with a legal aid/SLAS arrangement would be to ensure that clients benefited from statutory costs protection, thereby avoiding the need for expensive ATE.

88. A more radical option for a SLAS which would tackle the problem of adverse selection head on would be to make recoverability of uplifts and premiums under a CFA subject to the client having first sought funding through a SLAS, ie. The SLAS would have to be the first port of call. Whilst this would greatly enhance the viability of a SLAS and the potential to expand financial eligibility, it would inevitably have a severe and probably terminal effect on the ATE market (and therefore the CFA market as well) for any cases within the scope of such a

scheme. Such a model would not, therefore, be consistent with our key assumption that the CFA system should remain an important option for clients.

89. A particularly creative opportunity that now falls to be considered following the development of third party funding is to consider combined funding between legal aid/SLAS and commercial third-party funders. (The potential role of third-party funding is considered in more detail in section C of this report). One of the significant policy concerns over increased third party funding is whether it will lead to litigation being brought unnecessarily, the motivation being purely whether the third-party funder can see a commercial opportunity in pursuit of the claims. These concerns would be largely eliminated if combined funding were available for actions which the LSC had already approved on the merits, especially for cases held by the LSC to have a significant wider public interest.

Legal Framework

90. There appears to be legal scope for a SLAS without the need for new primary legislation. The Access to Justice Act 1999 provides for three main funding mechanisms:

    (a) Legal aid ie. cases funded by the LSC as part of the Community Legal Service, governed by part 1 of the 1999 Act.

    (b) Conditional fee agreements under section 27 of that Act (which created new sections 58 and 58A of the Courts and Legal Services Act 1990).

    (c) Litigation funding agreements under section 28 of the 1999 Act (section 58B of the 1990 Act). A litigation funding agreement is an agreement under which a funder agrees to fund legal services for a litigant who agrees to pay a sum to the funder in specified circumstances. (This provision, which has not yet been brought into force, could theory be used as the basis for a CLAF, but more

practically for a SLAS.)

91. Although presented as three separate options it does not follow that the 3 are mutually exclusive – an important legal issue is whether it is permissible for the same costs to be funded both by the LSC under part 1 and also subject to a CFA or litigation funding agreement under part 2. For now we have assumed that this is permissible.

92. Some other features of the legislation worthy of note are:

(a) For any legal aid case (i.e. cases funded by the LSC as part of the CLS) legal aid cost protection applies. Regulations can restrict the scope of cost protection in legal aid cases but there does not appear to be any mechanism to expand cost protection beyond legal aid cases.

(b) The obligation on legal aid clients to pay contributions towards the cost of their case are widely drawn. Section 10(2)(c) allows for contributions to be contingent on outcome and to exceed the costs to the fund for the case. This mechanism was expressly introduced into the 1999 Act to allow for self-funding systems within legal aid but the provision has not been used to date. Any contribution under this section would of course be payable by the client, potentially out of damages, but could not as such be recoverable from the opponent.

(c) The CLAF mechanism under section 28 is not unrestricted. Although the traditional view of a CLAF or SLAS mechanism is a simple levy on damages, the act provides that the sum payable under a CLAF or SLAS must be "calculated by reference to the funder's anticipated expenditure in funding the provision of the services…." (section 58B(3)(e) of the 1990 Act). So the levy must be limited by reference to the costs although that would

presumably not prevent it also being restricted by reference to the amount of damages recovered.

(d) The profit element of a CLAF or SLAS could, under Rules of Court, be made recoverable from the opponent in a successful case just like the success fee in a conditional fee agreement (section 58B(8)

(e) An insurance premium against other side cost liability could also be made recoverable under section 29 of the Access to Justice Act 1999. This possibility is not dependant on either a CFA or litigation funding agreement being in place.

KEY ISSUES FOR SLAS MECHANISM:

In successful cases from which source should the levy payment to the SLAS be deducted or paid?

93. This is the most important policy issue for a SLAS. There are three main options, which are not mutually exclusive:-

(a) The client could pay the sum to be deducted from damages recovered. This raises the important question whether recovery of 100% of client damages is sacrosanct. It is worth remembering that in their original format when introduced in 1995[10], CFA's were based on the principle that the success fee would be recovered from the clients damages up to a maximum level of 25% (recommended by the Law Society). This system appeared to work well without controversy or complaint or satellite litigation. The concept of a deduction from damages is

not a novel one, and is a feature of all the CLAF schemes we examined (see Part A and Appendix 8).

However, it may be necessary to distinguish between different heads of damage, as a deduction from a pain and suffering award may be easier to justify than a deduction representing actual loss through special damages or future costs of care.

(b) The claimant's lawyer could contribute a percentage of successfully recovered inter partes costs, (as used to be the case under the pre-1988 Legal Aid Scheme).

(c) The opponent could pay the levy in addition to normal costs and damages liability. If this were done, it would be important to define this additional liability as closely as possible in the appropriate regulations to reduce the prospect of satellite litigation.

Who should be liable for other side costs in unsuccessful cases?

94. There are at least four options here:

(a) Costs are not recoverable by the opponent because legal aid cost protection applies.

(b) ATE insurance is purchased if available. If so how would the premium be funded? The advantage of purchasing a premium is its potential recoverability under section 29.

(c) The funder of the litigation assumes liability for other side costs. If so any such liability should perhaps be capped along Arkin

[10] The Conditional Fee Agreements Regulations 1995

principles, so then liability to the other side should not exceed the level of investment in the case.

(d) The client remains liable for other side costs. This would be a serious deterrent to the would-be litigant seeking access to justice.

How should the levy/payment to the SLAS be determined?

95. Should this be a CFA style uplift on costs or a CLAF style levy on damages? One approach would be to have an uplift, based on costs with a maximum of 100% on between the parties costs (as for CFA's), but to enforce a binding cap so that (assuming the client pays) the client cannot lose more than, say, 25% of net damages. As discussed this would have some similarities with the conditional fee regime prior to April 2000. In group actions where calculation of the levy may be complicated by the distinction between individual and generic costs which may be funded in different ways particular considerations would need to be crafted.

What remuneration should apply to claimant lawyers in successful cases?

96. Subject to any percentage deduction from between the parties costs (if that were chosen as the mechanism to fund the SLAS) the normal regime would be for claimant lawyers to recover full costs from the other side in successful cases. However if any levy/payment to SLAS is made by the other side rather than the client, should that element be split by the funder and the claimant lawyers? As canvassed in the Carter report this could depend on the degree of risk borne by the funder and the lawyers.

What remuneration should claimant lawyers receive in unsuccessful cases?

97. The options include full funding of the costs, funding at prescribed legal aid rates, funding of disbursements only or a full CFA regime. If the assumption is that a SLAS would operate as part of main stream legal aid then payment at legal aid rates would seem to be the likely solution although there is a case for the funding available to be reduced in exchange for a share of the success fee.

Possible SLAS Models

98. There are therefore a very large number of variables and numerous different funding options. However the issues above cannot not be looked at in isolation: For example if an opponent is liable to pay the levy element, that will affect the arguments in favour of opponents being able to recover their costs in successful cases. The most likely models therefore need to be kept to a manageable number which can be analysed, consulted upon, and financially modelled. The question of who should pay for the levy element is worth addressing first because many other issues fall from that decision. Therefore the first model to consider (below) is one where the client pays this out of damages. The other models that follow are variations on types of the recoverable element.

POSSIBLE SLAS MODELS

MODEL A: Legal Aid with a levy out of damages

- This model operates like normal legal aid except a successful client pays an additional contribution out of damages recovered into the fund

- There is no need to change existing rules on legal aid cost protection.

- There is no need to change remuneration provisions

- The Hong Kong model suggests a 10% levy on damages (6% only for straightforward personal injury) but this may not sufficient to ensure self-financing.

Questions:

- How should the levy be calculated: By reference to costs or damages or both?

- Can the contribution be a straight levy on damages in the nature of a contingency fee despite this not being permitted as such under other parts to the Act?

- If the levy is calculated by reference to costs should this be on legal aid or between the parties rates?

- Should any levy related to costs be capped at a maximum 25% of net damages (after any shortfall in the recovery of costs has been taken out of gross damages awarded)?

Model B: Legal Aid with levy on recovered costs

- This would re-introduce the old system of claimant lawyers paying a percentage of their recovery of between the parties costs in successful cases into the Fund. The levy would need to be restricted to costs (not disbursements) and counsel's fees, but would not apply to disbursements.

- It would be difficult to apply the logic of such a system to net payments out of the fund in unsuccessful cases as those payments are already at prescribed rates which are a very significant reduction from inter partes rates.

- In the absence of any compensatory increase in other sources of remuneration for claimant lawyers, any significant deduction from inter partes recovery may jeopardise the profitability of such work. Therefore, a small deduction may be appropriate, perhaps the 10% which used to apply prior to the 1988 Act.

- Such a system of a levy on between the parties costs at 10% would not of itself lead to a self-financing system for the categories of case under consideration. However, such a system could be combined with other models such as Model A.

- Under this system there seems no reason to change the rules on legal aid costs protection or any other aspect of legal aid funding.

Model C: Levy recoverable from opponents, but cost protection remains

- In the context of group actions this model would probably be restricted to generic costs.

- It may be too harsh to make opponents liable for double costs if they lose but not to allow them to recover their costs at all if they win.

- Under current legislation the amount recoverable must be linked to the costs, limited to 100% of the between the parties costs.

- Any recoverable levy does not need to be limited by reference to the level of damages.

- It is not clear whether there is any difference between using the statutory provisions relating to CFAs combined with legal aid or those under section 28 combined with legal aid.

Questions:

- How should the success fee be shared? If legal aid remuneration remains as at present would the success fee go to the Legal Aid Fund?

- If legal aid covered only disbursements or a lower proportion of profit costs how should the division of the levy be calculated?

Model D: Levy recoverable from opponents, and opponents' costs covered by insurance

- There is an advantage to purchasing insurance if the insurance premium is recoverable.

  Questions:

- Who should pay for the ATE?

- What if ATE is not available?

- Otherwise similar issues arise as with model C.

- Models C and D have much in common with earlier Law Society proposals for a Conditional Legal Aid Fund (COLAF).

ANALYSIS AND RECOMMENDATIONS

The Client's right to Damages – Pros and Cons of Model A

99. There is a general expectation in England and Wales that claimants who are wholly successful should receive as near as possible 100% of the damages to which they are entitled. This is generally true both for the current CFA regime and for most legal aid cases, since our costs rules in principle allow for full cost recovery.

100. The assumption that 100% damages recovery is essential to effective access to justice is not shared in most other jurisdictions**,** particularly those where contingency fees are the primary source of funding. The same is also true where between the parties costs are restricted. For example, in New Zealand, as a matter of policy between the parties costs are limited to about 60/70% of what is considered to be reasonable for costs as between solicitor and own client, so that in most successful cases there will be some shortfall to be taken out of damages.

101. A good example close to home is the CFA regime as it operated prior to the introduction of recoverability in April 2000. Originally, under the 1990 Courts and Legal Services Act, the uplift on success and any premium incurred were taken from client damages. This was subject to Law Society guidelines (in practice widely followed) that the deduction from client damages should not exceed 25%. There is no evidence of client dissatisfaction with this regime (25% is also a common level of deductions from damage under Court approved contingency fee arrangements in other common law jurisdictions).

102. Whether a distinction should be drawn between general and special damages is worthy of debate but would add extra complexity to the system. Loss of a percentage of special damages intended to compensate for past or future expense may have more potential to cause hardship to the client, but general damages are

no less valuable to the client than special damages. Probably the most important consideration is the overall level of deductions from damages. As long as the client always retains at least 75% of total damages, it may not be necessary to distinguish between different heads of damage.

103. It may be said that one of the dangers of a levy on damages is that it might inflate damages claimed. However, there was no evidence of this under the pre-2000 CFA regime. Judicial control of damages awards should provide a sufficient safeguard against unwarranted damages inflation.

104. What should the parameters of a percentage reduction from damages under a SLAS be? At the global level it may be that a 10% levy on damages would make the Scheme fully self-financing, but this might produce injustice for large damages claims. At one end of the spectrum in a clinical negligence Cerebral Palsy claim the client may recover damages in excess of £1 million. Even on a 10% damages levy for a SLAS, this would result in benefit to the Legal Aid Fund in excess of £100,000. This might be difficult to justify. Deductions from damages may seem disproportionate either where the percentage deduction provides a very high figure, or where the level of deduction appears disproportionate to the level of costs. It may therefore an argued that any right of recovery by a SLAS should be linked to the level of investment and risk undertaken by the funder, which should be proportionate to any gain from the recoupment of a percentage of damages.

105. Therefore, the levy element of a Model A SLAS should perhaps be based both on the level of damages recovered and the level of costs incurred. Detailed options will require financial modelling but, by way of illustration, possible approaches could include:-

(a) A levy of, say, 10% on damages recovered but subject to the safeguard that this levy must not exceed 100% of the total costs

of the case to the funder (at legal aid rates).

(b) A levy from damages based on, say, a 50% or 100% uplift on the costs incurred by the funder at legal aid rates but subject to the safeguard that this must never amount to more than 25% of the net damages.

106. Some of the concerns about damages reduction are easier to justify in the context of group litigation. In group actions it is almost inevitably the case that claims can only be brought through large numbers of claimants coming together and sharing legal representation and costs, gaining strength in numbers. In doing so, individual claimants may need to sacrifice some of the freedom to pursue individual issues that would apply to a solitary claim. In a similar way, as there is inevitably a limit to the amount of public funding available for group actions, it may be a justifiable price for the claimant to pay to forego a share of damages as part of the system necessary to ensure access to justice.

107. Because of the dangers of adverse selection and the difficulty of predicting that a newly introduced SLAS system could be fully self-funding, as discussed above it may be necessary for the SLAS mechanism to be applied to **all** legal aid funded clients (not just new clients who may be brought into scope by increases in financial eligibility rules). For clients who are already within the financial scope of legal aid funding, such a reduction in damages amounts to the reduction of an existing right. It is therefore arguable that a Model A SLAS should only be adopted if the other models are found to be too problematic to implement. However, as discussed below, each model has its own difficulties. Ultimately, at its simplest level, the political decision whether a Model A type SLAS is desirable involves weighing up whether it is better to use limited public funds to buy 100% access to justice for a certain proportion of the population, or to use the same money to help more people on the basis that all will gain access to only 90% of their compensation.

Levy on Inter Partes Costs – Pros and Cons of Model B

108. In funding non-family litigation the role of legal aid is often simply to act as a banker to fund cases on account and as an insurer in providing limited legal aid funding for cases which are unsuccessful. The primary source of revenue for most legal aid claimant solicitors is between the parties costs. For example, for clinical negligence, on average claimant lawyers receive two-thirds of their income in legal aid cases from between the parties orders and one-third in payments from the Fund. Any reduction in the value of between the parties costs recovered obviously reduces the profitability of legal aid work as a whole, although if a reduction is of the order of 10%, this is less likely to be fatal to the business model.

109. A potential difficulty with a Model B SLAS is whether the reduction in between the parties costs breaches the indemnity principle, and if so whether that can be cured by regulation.

110. The acceptability of a reduction in costs may depend on the extent to which the levied element of the SLAS is reinvested in extensions in financial eligibility for the same subject area. For example in clinical negligence it appears that a 10% levy on inter partes costs (excluding disbursements) would reduce the net cost of the scheme to the fund by a little under 20%. As a result it might be possible to expand the number of cases supported by legal aid by up to 20% at the same net cost as the present scheme. This potential increase in business might to some extent offset the disadvantage of a small reduction in the profitability of successful cases.

111. It is, in any event, fairly clear that a Model B SLAS is very unlikely by itself to be fully self-financing. However, subject to modelling and the willingness of the

supplier base to operate such a system, a Model B mechanism could be the component of an affordable SLAS. The attraction of the arrangement is to emphasise a form of partnership between the LSC and suppliers which makes it possible to pursue more cases for clients.

A Costs Levy from Opponents – Pros and Cons of Models C and D

112. Models C and D give the greatest safeguards for the client, but raise serious issues as to fairness to the Opponent and long-term viability respectively.

113. Under Model C the opponent is in the unenviable position of having to pay costs plus uplift in losing cases, but being unable to recover costs at all if successful. However, the opponent's position is not necessarily worse than under the existing CFA regime. Under Model C no insurance premium is payable, so therefore an opponent who loses the case is better off under Model C than under a CFA, but worse off in successful cases.

114. Model D allows opponents to recover their costs when successful either from the ATE insurance or from the funder. In consequence Model D runs the highest risk of non-viability and thereby of increased exposure of public funds. There may be some lessons to learn from the Northern Ireland studies, albeit in relation to a different class of case, where assuming liability for other side's costs seriously affected the overall viability of the model. Given the key importance of statutory legal aid costs protection and the general acceptance under the legal aid regime of opponents being unable to recover costs, it seems unwise to abandon that key element of the scheme.

115. For clinical negligence claims and most other individual claims falling within the scope of legal aid funding, any increase in between the parties costs liability is likely to fall on public funds. Introducing a Model C or D SLAS in such cases may benefit the Legal Aid Fund but will essentially involve transferring funds

from one area of public expenditure to another. The considerations are, however, different for group litigation where the opponent is much less likely to be a public body.

116. One of the features of Model C or D, and indeed of CFAs generally, is that they all place prime importance on recovery of between the parties costs. Whilst on the one hand they create an incentive for opponents to settle early, they conversely create an incentive for claimants to issue proceedings and recover full costs, possibly at the expense of early resolution or ADR.

117. It would, of course, be counter productive if a new liability on opponents to pay costs gave rise to a fresh round of satellite litigation. This risk can be mitigated by describing the parameters of such liability as clearly as possible in regulations. It may be appropriate to specify a fixed percentage uplift for all cases in regulations, perhaps at 50%, rather than leaving this to challenge and discretion in all cases. (Note that under Model D where ATE insurance is payable, recoverability of that premium may itself give rise to satellite litigation in the same way as for CFAs).

118. Ultimately the key difficulty with Model C is fairness to the opponent. The political issue is whether further one-way fee shifting under this model is a reasonable price to pay for increased access to justice.

SUMMARY

119. Whilst none of the options for a SLAS are without difficulty, we are satisfied that overall a SLAS mechanism as discussed in this Chapter would benefit access to justice in England and Wales.

120. All the different models of a SLAS have pros and cons that vary according to the type of case. If it is decided to explore the concept of SLAS further, the next step

should be detailed financial modelling of the options followed by a wide consultation by LSC/MOJ on the details of the scheme. Our provisional recommendation is that the most promising and simplest model for SLAS is the levy on damages, Model A, within the parameters discussed above, perhaps supported by a limited levy on costs under Model B. However, the more radical option of recovery from opponents under Model C is also of interest and could be the best alternative for group actions, perhaps combined with models (A) and (B) so that a small levy is spread amongst the different funding sources. Model (D) is probably the most difficult to implement in practice as reliance on the availability of ATE would be difficult for the categories of case likely to be covered by a SLAS.

121. Within Model A, a levy calculated by reference to damages recovered but capped by reference to costs is possibly the fairest model. Subject to financial modelling it should be possible to introduce such a system for all damages categories combined with new powers to waive income and capital eligibility limits without increasing the overall cost of the system to public funds.

Chapter C – THIRD PARTY FUNDING

<u>Recommendation 3</u> - Properly regulated Third Party Funding should be recognised as an acceptable option for mainstream litigation. Rules of Court should also be developed to ensure effective controls over the conduct of litigation where third parties provide the funding.

122. Third party funding is the provision of funds by individuals or companies who have no other connection with the litigation. A funder may provide the full legal costs of the proceedings, part fund, or fund only disbursements outlayed. Protection from adverse costs is often (but not exclusively) provided, and in some circumstances the funder may provide no direct funding at all, but agree to cover a party's potential exposure to adverse costs. In return, the funder would expect to make a financial profit for their outlay and attendant risk to investment.

123. The third party funder may calculate profit in a number of ways. It may be assessed by a percentage contingency fee, perhaps in addition to any costs recovered from the other party. Other third party funding agreements may stipulate a return based on a multiplier of the investment provided (eg, if the funder puts in £x he may require £x multiplied by y as a return on his investment).

124. Until recently, because of the still extant principles of champerty and maintenance third party funding has been relatively underdeveloped in England and Wales. It is now reasonably well established in insolvency cases, but funders have been cautious about exposing themselves to the greater and less easily

assessed risks of general civil litigation and because of vulnerability to the Court of Appeal decision that partially preserved the now ancient doctrine of maintenance (*Arkin v Bouchard Lines*[11]).

125. In Australia, third party funding has been a feature of civil litigation for about a decade. During that period the courts in Australia have tested third party funding against the key issues of access to justice, consumer protection, and the relationship between the funder, the lawyer, and the consumer. Third party funding has been challenged twenty times in the past eight years, and although some proceedings were stayed, no case has been struck out because of the existence of a funding agreement.

126. The Australian courts have demonstrated in their decisions and in obiter commentary that public policy is changing, and that it is no longer taboo for a party who provides funding for a case, to have a legitimate commercial interest in the outcome. The Standing Committee of Attorney's General of Australia recently published a consultation paper inviting views on the development of law that would facilitate and regulate this form of funding with a view to developing a common law doctrine on champerty and maintenance across the Australian States.

127. The English courts have taken the view that third party funding is now acceptable in the interests of access to justice, particularly where the prospective claimant is unable to fund their claim by any other means. In short, the individual's right to access to justice must ultimately be subsumed to the doctrinal concerns of champerty and maintenance. It is worth noting that conditional fee agreements (a form of contingency fee) have already swept away accusations of maintenance in the bringing of personal injury claims, by far the largest volume of contested litigation in the civil justice system. A detailed analysis of case law on third party funding appears at **Appendix 9.**

[11] Arkin v Bouchard Lines [2005] EWCA Civ 655

Analysis of the *Arkin* decision, and of the key decision of the High Court of Australia in *Fostif*, appear below.

128. A detailed analysis of the history of champerty and maintenance also appears at **Appendix 10**.

"Arkin"

129. The approach of the courts towards third party funding has developed since *MacFarlane v EE Caledonian Ltd (No.2)*[12] where a claims consultant who had maintained the action of an unsuccessful claimant was ordered to pay the costs of the successful defendant. The fact that the maintainer had not accepted liability for the successful party's costs tainted the contract with the claimant with illegality, quite apart from the additional illegality which arose from the champertous nature of the agreement.

130. The Court of Appeal has recently examined the question of third party litigation funding in more detail, in Arkin v Bouchard Lines Ltd. In that case the claimant, Mr Arkin, was a man without means. His lawyers were acting for him under a CFA. He was, however, only able to pursue his claim to judgment because of the financial support provided by a professional funder, MPC. The claim failed. Mr Arkin's lawyers recovered nothing. MPC's support for him cost them in excess of £1.3 million for no return. Very substantial costs had been incurred by the defendants and by the Part 20 defendants which together amounted to nearly £6 million. The Court explained (at paragraph 23) that "cost shifting" under which costs usually follow the event is not a universal rule in common law jurisdictions. The main principle that underlies the rule is that if one party *causes* another unreasonably to incur legal costs he ought, as a matter of justice, to indemnify that party for the costs incurred. The defendant, who has wrongfully injured a claimant and who has refused to pay the compensation

[12] 1995 1 WLR 366 Longmore J

due, should pay the costs that *he has caused* the claimant to incur so that the claimant receives a full indemnity. A claimant who brings an unjustified claim against a defendant, so that the defendant is forced to incur legal costs in resisting that claim, should indemnify the defendant in respect of the costs that *he has caused* the defendant to incur. The Court concluded:

> "23. … Causation is usually a vital factor when considering whether to make an award of costs against a party.
>
> 24. Causation is usually a vital factor in leading a court to make a costs order against a non party. If the non party is wholly or party responsible for the fact that litigation has taken place, justice may demand that he indemnify the successful party for the costs that he has incurred .."

131. The Court confined its attention to cases where application for an order for costs against a non party has been made on the ground that the non party has supported the unsuccessful claimant.

132. The Court examined a number of authorities including *Hamilton v Al-Fayed (No.2)*[13] in which Simon Brown LJ, after extensive consideration of the authorities, identified that there was a conflict between two principles: on the one hand the desirability of the funded party obtaining access to justice; on the other, the desirability that the successful party should recover his costs. He considered that where the funders were "pure funders" the former principle should prevail. There were indications that this result accorded with public policy. Simon Brown LJ recognised that one benefit of the principle that costs follow the event was that this deterred the bringing of actions that were likely to be lost. The fact that lawyers would assess the merits carefully before appearing under a CFA, and that the Legal Services Commission required a similar exercise before approving the grant of legal aid were likely to achieve the same benefit. Pure funders were less likely to exercise the same careful judgment. Nonetheless the desirability of access to justice prevailed.

133. The Court of Appeal then considered a recent Privy Council decision *Dymocks Franchise Systems (NSW) Pty Ltd v Todd*[14]. In that case Lord Brown of Eaton-Under-Heywood set out the principles to be derived from the English and Commonwealth authorities.

134. "36.

1) Although costs orders against non-parties are to be regarded as "exceptional", exceptional in this context means no more than outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense. The ultimate question in any such "exceptional" case is whether in all the circumstances it is just to make the order. It must be recognised that this is inevitably to some extent a fact-specific jurisdiction and that there will often be a number of different considerations in play, some militating in favour of an order, some against.

2) Generally speaking the discretion will not be exercised against "pure funders", described in paragraph 40 of *Hamilton v Al Fayed* as "those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business, and in no way seek to control its course". In their case the court's usual approach is to give priority to the public interest in the funded party getting access to justice over that of the successful unfunded party recovering his costs and so not having to bear the expense of vindicating his rights.

3) Where, however, the non-party not merely funds the proceedings but substantially also controls or at any rate is to benefit from them, justice will ordinarily require that, if the proceedings fail, he will pay the successful party's costs. The non-party in these cases is not so much facilitating access to justice by the party funded as himself gaining access to justice for his own purposes. He himself is "the real party" to the litigation, a concept repeatedly invoked throughout the jurisprudence - see, for example, the judgments of the High Court of Australia in *Knight* and Millett LJ's judgment in *Metalloy Supplies Ltd (in liquidation) v MA (UK) Ltd*[15] Consistently with this approach, Phillips LJ described the non-party underwriters in *TGA Chapman Ltd v Christopher*[16] as "the defendants in all but name". Nor, indeed, is it necessary that the

[13] [2002] EWCA Civ 665
[14] [2004] UK PC 39
[15] [1997] 1 WLR 1613
[16] [1998] 1 WLR 12

non-party be "the only real party" to the litigation in the sense explained in *Knight*, provided that he is "a real party in ... very important and critical respects" - see *Arundel Chiropractic Centre Pty Ltd v Deputy Commissioner of Taxation*[17], referred to in *Kebaro* at pp 32-3, 35 and 37. Some reflection of this concept of "the real party" is to be found in CPR 25.13 (2) (f) which allows a security for costs order to be made where "the claimant is acting as a nominal claimant".

4) Perhaps the most difficult cases are those in which non-parties fund receivers or liquidators (or, indeed, financially insecure companies generally) in litigation designed to advance the funder's own financial interests."

135. The Court of Appeal, having considered these principles, did not dispute the importance of helping to ensure access to justice but considered that appropriate weight should be given to the rule that costs should normally follow the event:

> "38. … In our judgment the existence of this rule, and the reasons given to justify its existence, render it unjust that a funder who purchases a stake in an action for a commercial motive should be protected from all liability for the costs of the opposing party if the funded party fails in the action. Somehow or other a just solution must be devised whereby on the one hand a successful opponent is not denied all his costs while on the other hand commercial funders who provide help to those seeking access to justice which they could not otherwise afford are not deterred by the fear of disproportionate costs consequences if the litigation they are supporting does not succeed."

136. The court pointed out that a funder who entered into an agreement which is champertous would be likely to render himself liable for the opposing party's costs without limit should the claim fail. The solution put forward by the Court of Appeal was as follows:

> "41. We consider that a professional funder, who finances part of a claimant's costs of litigation, should be potentially liable for the costs of the opposing party *to the extent of the funding provided.* The effect of this will, of course, be that, if the funding is provided on a contingency basis of recovery, the funder will require, as the price of the funding, a greater share of the recovery should the claim succeed. In the individual case, the net

[17] [2001] 179 ALR 406

recovery of a successful claimant will be diminished. While this is unfortunate, it seems to us that it is a cost that the impecunious claimant can reasonably be expected to bear. Overall justice will be better served than leaving defendants in a position where they have no right to recover any costs from a professional funder whose intervention has permitted the continuation of a claim which has ultimately proved to be without merit."

In giving its decision in "Arkin" the Court of Appeal said:

"42. If the course which we have proposed becomes generally accepted, it is likely to have the following consequences. Professional funders are likely to cap the funds that they provide in order to limit their exposure to a reasonable amount. This should have a salutary effect in keeping costs proportionate."

Fostif[18] and Trendlen[19] – The High Court of Australia

137. Beyond the recent decisions of the England and Wales courts, perhaps the most influential and far reaching implications for third party funding of litigation are contained in the joined cases of Fostif and Trendlen, considered by the High Court of Australia. As Fostif was the leading judgment, and Trendlen followed Fostif this paper will only consider the findings of the court in the Fostif judgment.

138. Both cases involved the attempted recovery of payments of state based license fees (Fostif for tobacco, Trendlen for petroleum) that had been found to be unconstitutional.

139. Firmstones, a firm of accountants, wrote to tobacco retailers seeking their authority to act on their behalf to recover fees paid. They offered to fund the litigation, and protect the retailers from adverse costs in the event that they lost the claim, in return they would take one third of any recovery, plus any recovered costs.

[18] Campbells Cash and Carry Limited v Fostif Pty [2006] HCA41. Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd [2006] HCA42
[19] Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd [2006] HCA42

140. Firmstones instructed solicitors to "front" the action, on terms of instruction that severely limited access to their clients, who to all intents and purposes were represented by Firmstones.

141. The claim was set down as a "representative proceeding" (there are no group litigation or class action proceedings in New South Wales), with only one single identified claimant, but with an **opt-in** provision intended to permit other parties, once identified and willing to participate, to join the proceedings.

142. At first instance the defendant (Campbells) applied to have the proceedings dismissed or stayed on the grounds that (i) the proceedings were not properly constituted due to lack of cause common interest the action was not sufficiently representative, and (ii) that the third party funding arrangements amounted to an abuse of process because of intermeddling, and the degree of control exercised over the proceedings by the funders (Firmstones).

143. The first instance judge, Einstein J, decided that the funding arrangements were contrary to public policy and that the proceedings as constituted did not meet the requirements of a representative action. He entered a stay.

144. The decision of Einstein J was successfully appealed to the Court of Appeal of New South Wales that rejected both grounds of the stay at first instance.

145. On further appeal the High Court (Australia's final appeal process) decided by a majority of 5:2 that the case did not meet the procedural requirements to become a representative proceeding, and stayed the case, allowing that limb of the appeal.

146. However, the Court also removed the stay on the basis of the second limb of the appeal by a majority of 5:2 (a differently constituted majority decision) that the

third party funding arrangements did not constitute an abuse of process, and that the arrangements were not contrary to public policy. The appeal therefore succeeded on this ground, giving strengthened legitimacy to third party funding in Australia.

147. For the majority, Chief Justice Gleeson wrote[20]:

> "Even if the intervention of a litigation funder seeking to promote an assertion by more retailers of their rights be regarded as some form of intermeddling there is no justification for denying the existence of the matter."

148. Also for the majority Justices Gummow Hayne and Crennan wrote:

> "The appellants submitted that special considerations intrude in "class actions" because, so it was submitted, there is the risk that such proceedings may be used to achieve what, in the United States, are sometimes referred to as "blackmail settlements". However, as remarked earlier in these reasons, the rules governing representative or group proceedings vary greatly between courts and it is not useful to speak of "class actions" as identifying a single, distinct kind of proceedings. Even when regulated by similar rules of procedure, each proceeding in which one or more named plaintiffs represent the interests of others will present different issues and different kinds of difficulty…."[21]

> "The difficulties thought to inhere in the prosecution of an action which, if successful, would produce a large award of damages but which, to defend, would take a very long time and very large resources, is a problem that the courts confront in many different circumstances, not just when the named

[20] At paragraph 19
[21] Paragraph 94

plaintiffs represent others and not just when named plaintiffs receive financial support from third party funders. The solution to that problem (if there is one) does not lie in treating actions financially supported by third parties differently from other actions. And if there is a particular aspect of the problem that is to be observed principally in actions where a plaintiff represents others, that is a problem to be solved, in the first instance, through the procedures that are employed in that kind of action. It is not to be solved by identifying some general rule of public policy that a defendant may invoke to prevent determination of the claims that are made against that defendant..”[22].

“It follows that the funding arrangements made and proposed to be made by Firmstones did not constitute a ground to stay the present proceedings”[23]

149. Also for the majority Kirby J wrote:

“To lawyers raised in the era before such multiple claims, representative actions and litigation funding, such fees and conditions may seem unconventional or horrible. However, when compared with the conditions approved by experienced judges in knowledgeable courts in comparable circumstances, they are not at all unusual. Furthermore, the alternative is that very many persons, with distinctly arguable legal claims, repeatedly vindicated in other like cases, are unable to recover upon those claims in accordance with their legal rights...” and

“It is against the inherent inequalities, presented by these litigious facts of life, that a representative action may, under proper conditions, afford a litigant with an individual claim and a justifiable prospect to secure practical access to that litigant's legal rights in association with many others. The individual claim may (as in the case of many tobacco retailers in these proceedings) be comparatively

[22] Paragraph 95
[23] Paragraph 96

small and hardly worth the expense and trouble of suing. But the aggregate of the claims of those willing to proceed together, as proposed by a funder and organiser such as Firmstones, might be very large indeed. What is a theoretical possibility, as an individual action or series of actions, needs therefore to be converted into a practical case by the intervention of someone willing to undertake a test case, followed by others willing to organise litigants in a similar position, and under appropriate conditions, to recover their legal rights by helping them to act together..."

"Real access to legal rights: Apart from the foregoing considerations, it is important to recognise how exceptional it is for a court to bring otherwise lawful proceedings to a stop, as effectively the primary judge did in this case. It is very unusual to do so by ordering the permanent stay of such proceedings. The Court of Appeal recognised this consideration. Properly, it emphasised that it was for the appellants to establish that the respondents' proceedings constituted an abuse of process..."

"The reason why it is difficult to secure relief of such a kind is explained by a mixture of historical factors concerning the role of the courts; constitutional considerations concerning the duty of courts to decide the cases people bring to them; and reasons grounded in what we would now recognise as the fundamental human right to have equal access to independent courts and tribunals. These institutions should be enabled to uphold legal rights without undue impediment and without rejecting those who make such access a reality where otherwise it would be a mere pipe dream or purely theoretical"…

"The importance of access to justice, as a fundamental human right which ought to be readily available to all, is clearly a new consideration that stimulates fresh thinking about representative or "grouped" proceedings. It is this consideration

that has informed the decisions of other Australian appellate courts on such questions and also a decision of the Supreme Court of Appeal of South Africa".

"In my opinion those reasons disclose an attitude of hostility to representative procedures that is a left-over of earlier legal times. They are incompatible with the contemporary presentation of multiple legal claims. And, most importantly, they are fundamentally inconsistent with the rules made under statutory power and the need to render those rules effective"

150. The minority judgment of Callinan and Hayden JJ was firm in its disapproval of third party funding[24]:

"Institutions like Firmstone & Feil, which are not solicitors and employ no lawyers with a practising certificate, do not owe the same ethical duties. No solicitor could ethically have conducted the advertising campaign which Firmstone & Feil got Horwath to conduct. The basis on which Firmstone & Feil are proposing to charge is not lawfully available to solicitors. Further, organisations like Firmstone & Feil play more shadowy roles than lawyers. Their role is not revealed on the court file. Their appearance is not announced in open court. No doubt sanctions for contempt of court and abuse of process are available against them in the long run, but with much less speed and facility than is the case with legal practitioners. In short, the court is in a position to supervise litigation conducted by persons who are parties to it; it is less easy to supervise litigation, one side of which is conducted by a party, while on the other side there are only nominal parties, the true controller of that side of the case being beyond the court's direct control"…

[24] At paragraph 266

At the end of their judgment, they added[25]:

> "If that conclusion is thought by those who have power to enact parliamentary or delegated legislation to be unsatisfactory on the ground that the type of litigation funding involved in these appeals is beneficial, then it is open to them to exercise that power by establishing a regime permitting it. It would be for them to decide whether some safeguards against abuse should be incorporated in the relevant legislation.".

Australia post Fostif

151. Fostif has been interpreted in Australia as providing significant clarification of many issues surrounding third party funding - its legitimacy, the level of control exercised by third party funders, and what constitutes a legitimate representative opt-in action.

152. The Standing Committee of Attorney's General of Australia (SCAG) is also considering further the matter of third party funding post Fostif, with particular reference to consumer protection and the relationship between the solicitor the funder and the client. SCAG published a discussion paper in May 2006 (whilst Fostif was under consideration by the High Court); a report is anticipated in 2007.

153. In the recent paper the Victorian Law Commissioner Dr Peter Cashman commented;

> "The attempt made in the *Fostif* litigation to commence a representative action but only continue to conduct it for the benefit of those who agreed to the terms proposed by the litigation funders was de-railed by the High Court (by majority) for reasons which are not relevant for present purposes. However, the judicial

[25] At paragraph 289

imprimatur given to the commercial litigation funding arrangements is of broader significance.

In the absence of a class action fund or commercial litigation funding arrangements, many if not most 'economically rational' claimants would be deterred from agreeing to be a representative in class action litigation. The costs of conducting such litigation are enormous. The proceedings are likely to be protracted. There are likely to be numerous contested interlocutory battles. The potential liability for adverse costs and security for costs is likely to deter anyone who is not either poor or rich"...

Arkin, Fostif and the future of third party funding in England & Wales

154. In recommendation 13 of its first report the CJC canvassed the view that third party funding merited further examination as one of the options that would facilitate the funding of litigation for consumers. Aside from the procedural issue of representative actions (see Part 2 Chapter D) there is now clear evidence that the third party funder can have an important part to play in facilitating access to justice for consumers who cannot otherwise fund their case. (It could be argued that the Legal Services Commission is in effect a third party funder, albeit not for profit).

155. The conclusion is that third party funding should be encouraged, subject to (i) the constraints laid down by Arkin and (ii) suitable regulation of commercial third party funders to ensure consumer protection particularly in the retainer relationship between funder, lawyer and client, and who has control of the litigation. Such regulation could be by Rules of Court and/or the existing scope of Financial Services Regulation, and/or (possibly) new provisions of the Compensation Act in relation to claims handling.

156. Based on discussions with third party funders and an understanding of how third party funding arrangements currently operate in England & Wales it is proposed that subject to the control and regulation already referred to this method of funding has a potentially important and increasing part to play in providing access to justice in areas of litigation, such as group actions, where funding is currently a difficult if not impossible challenge.

157. Possible models for third party funding arrangements have not been described in this paper since they already exist in various forms currently used by commercial third party funders from whom examples can be obtained in further developing the details of this recommendation.

CHAPTER D - CONTINGENCY FEE FUNDING IN MULTI PARTY CLAIMS

Recommendation 4

In multi party cases where no other form of funding is available, regulated contingency fees should be permitted to provide access to justice. The Ministry of Justice should conduct thorough research to ascertain whether contingency fees can improve access to justice in the resolution of civil disputes generally.

158. There is growing interest in the area of consumer rights in multi party claims. A recent report in 2004, prepared for the EU[26] stated:

> "The picture that emerges from the present study on damages for breach of competition law in the enlarged EU is one of astonishing diversity".

A subsequent Green Paper on the same subject said:

> "While community law therefore demands an effective system for damages claims for infringements of anti trust rules, this area of the law in the 25 member states presents a picture of total underdevelopment…. The ECJ has ruled that…. it is for the legal systems of the member states to provide for detailed rules for bringing damages actions. "

[26] European Commission Competition DG. Study on the conditions of claims for damages in case of infringement of EU competition rules. 31 August 2004.

159. In July 2006 the DTI published a Consultation paper[27], in which the then Minister of State for Trade stated:

"We know many consumers feel unable to bring a court case on their own; while those who do may consider the size of their losses are outweighed by the potentially high legal costs."

160. In March 2007 the Government's budget speech[28] contained the following statements:

"Private actions are an important aspect of a well functioning competition regime. An effective regime would allow those affected by anti-competitive behaviour to receive redress for harm suffered and broaden the scope of cases that can be investigated, promoting a greater awareness of competition law and re-inforcing deterrence, without encouraging il-founded litigation….However to date very few private action cases have been brught before the courts in the UK….The Government welcomes the progress f the OFT has made on this issue and will continue to work with the OFT to identify key barriers to private actions."

161. A month later in April 2007 the OFT published a discussion paper[29] on facilitating private actions to optimise the effectiveness of competition law enforcement. Philip Collins, Chairman of the OFT said:

"A more effective private actions system would promote a greater culture of compliance with competition law and ensure that public enforcement and private actions work together to the best effect for business and consumers".

[27] Representative Actions in Consumer Protection Legislation. July 2006.
[28] Building Britain's long term future: Prosperity and fairness for families. Extracted from 3.45 to 3.48. hmtreasury.gov.uk/budget/budget_07/bud_budget_07_repindex.cfm
[29] Private Actions on Competition Law: Effective redress for consumers and busnesses

162. At paragraph 3.4 the paper says:

"Potential exposure to litigation costs may act as a major disincentive to the bringing of well-founded private competition law actions".

163. There is supporting evidence that in multi party cases funding and procedural problems mean that consumer rights are insufficiently protected. This has been recognised in research[30] and by institutions[31].

164. In the light of this growing momentum for reform, and interest both nationally and within the European Union to develop more effective procedures and funding arrangements for redress, in 2006 the Civil Justice Council conducted a "Chatham House" forum, attended by a broad range of stakeholders[32].

165. The event provided an early opportunity to test the emerging proposals for the establishment of a SLAS scheme (Part 2 Chapter B), and debate whether a deduction from damages would be acceptable where there were no other viable funding alternatives.

166. Conclusions from the stakeholder event were;

(i) Funding was the greatest barrier to bringing legitimate multi party consumer redress claims

(ii) It was widely accepted that proposals for alternative funding systems for multi party clams would take a percentage of damages.

(iii) The current group litigation procedure worked reasonably well but could be improved

[30] Ashurst's Report "Study on the conditions of claims for damages in case of infringements of EC competition rules" (Aug 2004)

[31] EU Green "Damages actions for breach of EC antitrust rules" (Dec 2005)

(iv) An opt-out procedure is appropriate in some consumer claims

(v) The judiciary should play a more pro active role in controlling and managing multi party litigation.

167. It was acknowledged that in the absence of a SLAS method of funding multi party actions other solutions would have to be found. If a SLAS is not introduced, regulated contingency fees should be introduced and the fee shifting rule abrogated.

168. As further development on consumer redress takes place in the EU and Government, the Civil Justice Council will prepare a supplementary paper of advice and recommendation to the Lord Chancellor on any reform necessary to the CPR to improve access to justice in this area of group consumer litigation.

A Wider role for contingency fees?

169. In its previous report, the CJC recommended that it was "time to give serious thought to allowing contingency fees as a **last resort**[33] "(*emphasis added*). The CJC now believes that it is prudent for Government to commence examination of alternative methods of funding in case the sustainability of the CFA/ATE market comes under threat. The CJC believes that a combination of; adverse market behaviour[34], 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

[32] Judiciary, academics, claimant and defendant lawyers, Government officials, consumer and advice representatives
Page 32, text leading to Recommendation 11
[34] In the shape of speccing and self insuring

ATE market is vulnerable with a consequence on CFAs. Should any one or a combination of these effects reduce ATE coverage, CFA's may fail as a result. It follows that in the absence of legal aid, contingency fees may need to become a mainstream funding alternative.

170. This recommendation supports Recommendation 5 of the Government's own Better Regulation Task Force in its report "Better Routes to Redress":

"The Task Force recommends that the [then] Department for Constitutional Affairs should carry out, by May 2005, research into the potential impact and effectiveness of contingency fees in securing access to justice I the UK."

171. In the [then] DCA rejection of this recommendation in November 2004, 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.

172. The CJC believes that if the ATE market ceases to offer its current broad range of protection then it will be the more vulnerable citizens (ie those who previously qualified for legal aid[35]) that will be left without access to justice, or will be steered toward using the services of claims managers whose charging method is to take costs from damages recovered.

173. The introduction of properly regulated contingency fees would simplify the funding system reducing satellite litigation and the role of costs intermediaries.

[35] When legal aid was removed for personal injury in 1999 the Government argued that CFA's would increase access to justice by bringing into the CFA regime the "minelas", middle income citizens who did not qualify for legal aid. Should ATE be removed from the majority of lower value personal injury claims, the "minelas" would continue to be protected under BTE appended to their house or car policies, but the disadvantaged would have no such protection, and therefore create an access to justice void.

This would save costs for those who ultimately pay for the litigation and for the lawyers involved in the litigation. There would also be a saving in the disproportionate amounts of time, cost, and Government resource spent on the Courts role in resolving costs disputes. Transparency and simplicity for the consumer clients would be a significant benefit under a contingency fee regime.

174. For these reasons the CJC considers it to be prudent for the Government to invest now in research into viable alternatives, rather than be placed in a position of having to act quickly to find solutions without independent factual research into alternatives.

175. The CJC will publish a further paper on this subject following more extensive study of the American and Canadian systems. The CJC has already studied in conjunction with US academics, judiciary and practitioners the operation of the tort system in the United States. A list of some of the material considered appears in **Appendix 4.** It should be noted that the contingency fee is not uniquely American. Contingency fees can be found in many other jurisdictions[36] including: Canada, Australia, New Zealand, Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Ireland, Lithuania, Slovakia, Slovenia, Malta, Japan, and England[37] . (Denmark, Greece, Ireland, Malta, and to a greater extent England operate conditional fee derivatives of the contingency fee).

[36] European Commission. Study on the conditions of claims for damages in case of infringement of EC Competition Rules, and from prior working knowledge.

[37] England and Wales in non contentious business only