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UPDATE ON PROPOSED REFORMS TO CIVIL LITIGATION FUNDING IN THE UK

Since the publication of Lord Justice Jackson's report entitled "A Review of Civil Litigation Costs" in January 2010, it has been clear that change would be coming to the UK's civil litigation funding regime[1]. Some felt that with the election of the country's first peace-time coalition government, and that government's inevitable preoccupation with issues of national debt, such changes would be put on the back burner, but a major overhaul of the current rules is now very clearly on the cards.

On 29 March 2011, the Lord Chancellor and Secretary of State for Justice, The Right Honourable Ken Clarke MP, presented the Government's proposals for the reform of civil litigation funding. The proposals are based on Lord Justice Jackson's recommendations and take into consideration the responses to a consultation process conducted by the government between November 2010 and February 2011.

THE LOSER DOESN'T ALWAYS PAY

A central tenet of UK litigation costs rules has been, since time immemorial, the costs-shifting mechanism or the "loser pays" principle whereby, in most circumstances, the losing party is required to pay the legal costs incurred by the victor in addition to its own legal costs and any damages awarded.

This principle has a profound impact on the litigation landscape in the UK: claimants are unlikely to take the risk of bringing weak claims in circumstances where they might ultimately be required to pay not only their own legal costs but also those of the defendant. Similarly, defendants are encouraged to settle meritorious claims at an early stage rather than risk paying damages and both parties' legal fees.

The Government's proposal will change this principle in two ways. Firstly, the Government intends to

1 *See* "Litigation in England: A Changing Landscape," *Jones Day Practice Perspectives: Product Liability and Tort Litigation*, Fall 2010, *available at* http://www.jonesday.com/files/upload/Litigation-in-England-A-Changing-Landscape.pdf.

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introduce a "qualified one way costs shifting" regime in personal injury claims (including clinical negligence claims). This means that individual claimants will no longer be at risk of paying a defendant's costs if they lose. There will be two principle exceptions such that (a) very wealthy individuals will not be included in the new regime and (b) a claimant that has acted "fraudulently, frivolously or unreasonably" in pursuing proceedings may still be required to pay the other side's costs. Defendants in personal injury cases, principally insurers and large, well-funded bodies such as the National Health Service, will remain liable for a claimant's costs if they lose, and the usual "loser pays" rules will continue to apply in all other cases.

The purpose of this change is said to be to promote "access to justice" but it remains to be seen whether such rules will lead to an increasing number of speculative claims and an acceleration of the trend towards a U.S. style "compensation culture" in the UK.

The second related change to the "loser pays" principle is the proposed abolition of the recoverability of conditional fee arrangement ("CFA") success fees and of after-the-event ("ATE") insurance premiums. These, in combination, had certainly increased dramatically the cost of being a losing defendant in English court proceedings.

CFAs allow a lawyer to act on a "no-win, no-fee" (or "no-win, low-fee") basis. Unlike in the U.S., such arrangements do not allow the lawyer to recover a share of any damages if he wins but rather to charge a percentage uplift (up to 100 percent) to his fees. Given that the uplift is only payable following a win and that, following a win, the loser pays, success fees are in effect paid by the party that did not negotiate or agree to them.

Whilst CFAs were intended to promote access to justice for those unable to afford lawyers' fees, the recoverability of the "success fee" uplift has been felt to have led to them being widely used as a tool to apply pressure on defendants to settle litigation. The pressure is such that, in a recent decision[2], the Europe Court of Human Rights held that the recoverability of CFA success fees constitutes a breach of the right to freedom of expression in the context of defamation proceedings.

ATE insurance also promotes access to justice by providing cover against the risk of being held liable for the other party's legal costs in the event of a loss. In most cases, the ATE premium is payable only in the event of success and, as we have seen, the "loser pays" which means the cost of this (often substantial) fee is transferred to him also. Again, this provides very little incentive for the party seeking ATE insurance to negotiate a low premium.

While the combination of a "no-win, no-fee" CFA and a deferred premium ATE policy may allow claimants to bring claims at no cost and no risk, such a combination often means that a losing defendant could be required to pay not only damages and the costs of its defence, but (a) the claimant's legal costs, (b) the claimant's lawyers' "success fee" and (c) an (expensive) ATE insurance premium. This is thought by some to encourage speculative claims particularly as the downside risks apply very significant pressure on defendants to settle even where they have good prospects of success.

It is perhaps unsurprising then that the Government now proposes to abolish the recoverability of CFA success fees and ATE insurance premiums.

WHAT MIGHT THIS MEAN IN PRACTICE?

Qualified one way costs shifting in personal injury claims will reduce the need for ATE insurance in such cases. In other litigation, the fact that claimants will be asked actually to cover the cost of any premiums is likely to result in reduced demand and perhaps downward pressure on costs. The lack of a wide and diversified ATE business (with premiums paid on successful claims covering insurer payouts on losses) may lead some insurers to pull out of the market.

Irrecoverable success fees will also lead to significant changes in the UK's "no-win, no-fee" model: claimants are unlikely to agree to such high uplifts in fees as previously. While the abolition of success fee recoverability might have left many claimant law firms struggling to maintain profitability, the introduction of U.S. style contingency fees will create many new opportunities.

2 *MGN Limited v United Kingdom* [2011] ECHR 66.

CONTINGENCY FEES FOR THE UK

The Government has declared its intention to introduce what it describes as "damages-based agreements" ("DBA") pursuant to which a claimant's lawyer will be entitled to charge a fee calculated as a percentage of any damages awarded.

In personal injury claims, DBA fees will be capped at 25 percent of damages (excluding damages for future care and loss) but these fees will be uncapped in other cases. Applying the "loser pays" principle, defendants will remain liable to pay the claimant's base legal costs (lawyers' fees at an hourly rate and any disbursements) in the usual manner, and any costs recovered from a defendant will be set off against the claimant's liability for the DBA fee.

This change represents a significant shift in civil litigation funding, but we remain unlikely to see the kinds of mass tort cases prevalent in the U.S. in the absence of a viable equivalent to the U.S. style class action. Both in the case of Group Litigation Orders and antitrust / anti-cartel litigation under the Enterprise Act 2002, group claims are "opt-in" rather than "opt-out" and damages are measured by reference to the losses suffered by individual claimants rather than to the profits made as a result of the anticompetitive behaviour.

This creates an effective cap on the level of damages such that claimant law firms cannot expect the level of payouts seen on the other side of the Atlantic. An example of this was the high-profile case relating to collusion to fix the price of replica football, "soccer", shirts that was brought by Which?, a consumer rights group, against JJB Sports, a retailer, under the Enterprise Act 2002. Despite media interest (including front page coverage in the UK's highest distribution newspaper) only a tiny fraction of those affected by the price-fixing were signed up: the total payout under an agreed settlement was only £20,000.

DBAs have been permitted in employment cases (where the recoverable fee is capped at 35 percent of damages) since April 2010 and there is a sense that they are slowly gaining ground. The changes to the manner in which CFAs operate are likely to accelerate this trend and DBAs also seem likely to replace CFAs in individual personal injury claims. DBAs will also be of interest in commercial claims by impecunious claimants—if a claim is strong enough, law firms may be willing to take the risk for a slice of the action.

Like many things however, a lot will depend on how DBAs are eventually implemented.

SETTLEMENT OFFERS: "PART 36 WITH A KICK"

The Government's proposed reforms also include a couple of interesting changes to Part 36 of the Civil Procedure Rules. Part 36 is designed to encourage the acceptance of reasonable settlement offers by imposing certain sanctions (primarily in respect of the treatment of costs) in the event that a party does not accept a qualifying offer but then fails to achieve a more advantageous result at trial.

The proposed reforms are two-fold. Firstly, the Government intends to make it clear that the costs sanctions in Part 36 will apply where a money offer is beaten at trial, by however small a margin. This is intended to reverse the controversial decision in *Carver v BAA Plc*[3] which suggested that all circumstances must be taken into account in determining whether the final outcome of a case was "more advantageous".

Secondly, the Government intends to impose an additional sanction where a defendant rejects a claimant's offer but fails to do better at trial. As the law stands, in such circumstances the defendant would be required to pay the claimant's costs on an indemnity basis (generally around 80 percent of the costs incurred) rather than the standard basis (around 70 percent of the costs incurred) together with interest on both damages and costs at a rate of up to 10 percent above base rate. The proposed new sanction, in money claims[4], is for the level of actual damages payable to be increased by 10 percent.

During the consultation process, the Government had suggested that this penalty might be scaled down for high value claims, and a number of responses to the consultation suggested that early offers could be incentivised by varying

3 [2008] EWCA 2008.
4 The government is still considering how to increase sanctions in relation to non-money claims.

the applicable penalty based on when the offer was made. There is no mention of either of these points in the Government's proposal save for an oblique reference to the Government discussing "the details" with stakeholders in due course.

As always, the devil is in the details but it is clear that these reforms will shake up civil litigation funding in the UK. The Government has indicated that it would like to see these changes implemented by the Autumn of 2012, and we await the publication of draft legislation with interest.

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