Conditional fees, after the event insurance and other litigation funding mysteries - updated

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Litigation costs in England and Wales

All businesses and organisations have to deal with disputes from time to time and most will seek successfully to resolve these by negotiation, mediation or informal routes. As a last resort, a formal resolution in the civil courts may be necessary, but only after a careful analysis of the costs of doing so.

Charities face the same problems and increasingly so. If the statistical evidence is right, disputes about wills have been increasing in number in recent years. Disputed legacies place the charity trustees in a difficult position as they are obliged to ensure that the charity receives full benefit from the testator’s generosity, but equally need to ensure that charitable funds are used sensibly on legal fees and a commercial approach is taken to litigation.

It is only in limited circumstances that charities need to obtain the consent of the Charity Commission or court before litigating. Essentially this boils down to two types of dispute: proceedings which are internal to the charity (such as an action against a charity trustee for, say, fraud) and significant external claims where the costs incurred are likely to be material to the charity’s functioning.

In situations where charities are concerned about the merits of a case, entering into a funding agreement with the lawyer whereby the risks of the litigation are, in effect, shared or obtaining insurance against adverse costs, if it is available, may help allay the risk of allegations that funds have been spent unwisely should the case ultimately be unsuccessful.

It is important for those responsible for making the decision to go to court to understand not just how much a case might cost but also the various ways costs can be funded, both by the charity and by the opposing party, and how these funding choices can affect the progress and the cost of the case and the likelihood of settlement in particular.

Costs of litigation

The English Civil Procedure Rules 1998 (CPR) define costs in Rule 43.2 as follows:

‘costs’ includes fees, charges, disbursements, expenses, remuneration, reimbursement allowed to a litigant in person under rule 48.6, any additional liability incurred under a funding arrangement and any fee or reward charged by a lay representative for acting on behalf of a party in proceedings allocated to the small claims track.

In practice, litigation costs are typically represented by three elements:

1. your own legal advisers’ fees
2. expenses – commonly referred to as disbursements, eg court fees, barrister or expert fees
3. your opponent’s legal fees and disbursements.

The presumption under the CPR is that in most cases the party who loses the case (or an interim application) will be ordered by the court to pay the costs of the successful party. Such orders are commonly referred to as ‘adverse costs orders’ and the presumption often known as the “English Rule’. Costs ordered to be paid are subject to assessment by the court, so it is rarely a complete indemnity.

In recent years, the method that a party uses to pay both its own litigation costs and any adverse costs has become known as ‘Litigation Funding’. But this is also the label applied to a specific and relatively new source of funding.

Funding options for litigation costs

- Public funding (ie Legal Aid)
Legal expenses insurance or LEI, BTE or ATE

Trade union or professional organisation funding

Lawyers’ fee arrangements

Traditional pay-as-you-go

Fixed fee

Conditional fee agreements or CFAs

Third party funding or TPF

Public funding for civil claims (Legal Aid)

Legal aid is now only available to individual litigants through law firms or law centres that hold a contract with the Legal Services Commission. In civil matters it is only available for a very limited range of disputes and is subject to both a means test and a merits test. Even if eligibility is established, a contribution to costs may be required and the funding may effectively be a loan. The recipient of legal aid is generally protected from adverse costs orders even if unsuccessful.

Legal expenses insurance or LEI

Insurance policies can cover your own and/or other side’s legal fees and disbursements in litigation. Unlike conventional insurance, LEI does not make a direct payment to the insured for a claim. Instead, the insurance covers the legal costs involved in pursuing or defending a claim. There are two types of policy available to both individual and business litigants:

Before the Event or BTE Insurance is a common add-on to domestic insurance policies and occasionally to directors & officers policies and typically may cover personal injury claims, employment or consumer-related disputes and some property-related claims but generally not wills and inheritance disputes. Cover may be limited in amount but does include own legal costs and adverse costs.

After the Event or ATE Insurance can be purchased by individuals or businesses after the dispute has arisen and typically provides protection against adverse costs orders. Although premiums are relatively high, they are usually deferred or self-insured and only become payable in the event of success. Premiums can also be incurred in stages, increasing as the case progresses closer to trial. The premium can also be recovered as a part of the successful party’s legal costs as an ‘additional liability’. ATE cover for defendants is in theory available, but can be hard to secure.

Trade union or professional organisation funding

Individuals who are members of a trade union or a professional organisation may be able to obtain funding from them to cover payment of own lawyers’ costs.

Flexible fee arrangements from the lawyer

Traditional model: lawyers charge an agreed hourly rate for the work carried out and send regular invoices to be paid by the client as the case progresses.

Fixed fees: increasingly being used in transactions but can be used for litigation although generally appropriate for pre-action assessments or clearly defined stages of a dispute.

Flexible fee arrangements: a lawyer’s ability to be more creative in how litigation is paid for is limited in England and Wales by a fundamental rule of law known as the ‘Rule against Champerty and Maintenance’. This prohibits US-style contingency fees, whereby a litigation lawyer is paid a percentage of the client’s winnings:

Maintenance is the improper support of litigation in which the supporter has no legitimate concern, without just cause or excuse.

Champerty is a variety of maintenance, and occurs when the maintaining party contracts for a share of the proceeds of the case.

Although the courts have moderated the rule in relation to non-lawyers, it still applies with full vigour to lawyers and is incorporated into the Solicitors Act. It is therefore illegal for a lawyer in England and Wales to conduct litigation on a contingency basis – with one exception:

A Conditional Fee Agreement or CFA: a statutory exception to the rule, first introduced in 1995 and permitted for most civil claims (aside from family matters) from 2000 to coincide with the curtailment of civil legal aid, and intended to ensure access to justice for those individuals who could not afford to pay lawyers’ fees. CFAs are heavily used in personal injury cases, but can also be used in other disputes and are available to both individuals and businesses.

Under a CFA, the lawyer agrees to charge either no fee or a reduced fee as the case progresses and the client agrees that if the case is successful it will pay normal fees plus an uplift, or success fee, which must be defined as a percentage of normal fees, up to a maximum of 100%. The success fee percentage can be set in stages, increasing as the case progresses closer to trial. A success fee can be recovered from the losing party as an ‘additional liability’ along with the normal fees.

Third party funding TPF

Third party funding is the provision of funds to pay legal costs by individuals or others who have no other connection with the litigation. Traditionally such funding might have been provided by friends, family or shareholders. Now there is an active market for commercial litigation
funders who will ‘invest’ in a claim, that is, pay all the claimant’s legal costs, in return for a financial profit, or fee, for their outlay and risk. So long as the funder does not seek to control the course of the litigation, the courts are prepared to regard such arrangements as legal.

The usual structure is that a funder agrees with the client that it will finance the cost of a claim on a non-recourse basis in return for a fee that is (usually) calculated as a percentage of damages or as a multiple of the funder’s outlay. The fee is generally only payable from the damages / costs awarded in the event of success. The fee is not recoverable from the losing party. If the case is unsuccessful the funder goes unpaid and adverse costs will usually be covered by ATE arranged or paid for by the funder.

Commercial litigation funding, as it is more formally known, is a relatively new market, and most ‘investors’ in litigation look for high value money claims, where damages are likely to be in the millions, with strong merits and a defendant with deep-pockets.

The effect of funding on the litigation

If you are being sued by a claimant who has a CFA and ATE insurance, it tells you three things: their lawyer and an insurance company believe their claim has a good chance of succeeding; they may be paying no legal fees and be protected from any risk of paying your costs if you win; and if they win, they will be adding a success fee and the ATE insurance premium to the legal costs they will seek to recover from you. On the other hand, if they lose, you should have your costs covered by their ATE insurer. In the event of settlement, which is the usual outcome for a dispute, the lawyer, the insurer and the party will all have an interest in maximising the amount they receive from the deal. If both parties have CFAs with no ongoing legal fees to pay, this can make settlement harder to achieve.

You may not know that the claimant has secured funding from a litigation funder as there is no obligation to disclose this fact (in contrast to a CFA or ATE insurance) but if they do tell you, you know that any costs orders in your favour should be met but also that a funder has accepted that their claim has merit.

The future of litigation funding

There will be a change in the law next year to amend the rules of costs recovery to stop success fees on CFAs and premiums for ATE insurance being recovered from losing parties. This means that a successful litigant will have to pay these sums from the damages awarded. At the same time, the law on contingency fees will change, making it lawful for lawyers in England and Wales to take a percentage of their client’s damages as their fee. Neither change will be retrospective, but the effect on litigation funding is expected to be substantial. CFAs and ATE insurance may become less attractive to litigants, particularly individuals, and new models of third party funding, with lower fees, are expected to be made available to lower value claims. These changes are scheduled to take effect on 1 April 2013.
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