

<b>To:</b>	Legal Services Board	
<b>Date of Meeting:</b>	23 May 2013	<b>Item:</b> Paper (13) 33

<b>Title:</b>	Damages-based agreements
<b>Workstream(s):</b>	Workstream(s) (see Business Plan 2011/12)
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<b>Status:</b>	Unclassified

<b>Summary:</b>
<p>Legislation was introduced on 1 April 2013 permitting damages-based agreements between a person providing advocacy, litigation or claims management services and the recipient of those services.</p> <p>A number of risks have been identified with these agreements which suggest a possible need for targeted and proportionate regulation to minimise any danger of either deliberate or inadvertent mis-selling. We wrote to the approved regulators to ask how they planned to respond to the new legislation and deal with the risks it poses. Replies varied in detail, but all considered that it was appropriate to rely on their existing arrangements, at least in the shorter-term.</p> <p>Although it did not appear that any regulator had focussed on the issue ahead of the LSB's intervention, we consider that it would be disproportionate to offer specific guidance at this stage in the light of their responses. However, we intend to monitor developments in this area and the response of approved regulators to ensuring that good consumer outcomes are secured.</p>

<b>Recommendation(s):</b>
<p>The Board is invited to:</p> <p>i. discuss and agree the next steps at paragraphs 15 to 17.</p>

Consultation	Yes	No	Who / why?
<b>Board Members:</b>	X		Gateway paper sent to Barbara Saunders
<b>Consumer Panel:</b>	X		Steve Brooker
<b>Others:</b>	None		

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
N/A		

## LEGAL SERVICES BOARD

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### Damage-based agreements

#### Background

1. A damages-based agreement (DBA) is defined as:

An agreement between a person providing advocacy, litigation or claims management services and the recipient of those services. Where if the recipient obtains a specified financial benefit in connection with the matter in relation to which the services are provided, they will pay the person providing the services a defined amount of the financial benefit obtained.

2. From 1 April 2013 DBAs have been permitted for contentious work (i.e. litigation or arbitration proceedings) in England and Wales. This means that, for the first time, lawyers can conduct litigation and arbitration in this jurisdiction in return for a share of any damages.
3. Before 1 April such arrangements were not permitted for contentious work in England and Wales, although they were permitted for employment and other tribunal work (which is technically considered non-contentious business). In contrast, lawyers could conduct litigation under conditional fee agreements<sup>1</sup> (CFA). While raising similar issues, there are differences in the ways that CFAs and DBAs operate which mean that the implementation of this legislation presents some specific risks.
4. Under a traditional CFA, the risk on costs is borne by lawyers and the losing party – with the consumer buying insurance to alleviate the risk of any personal costs. With a DBA the consumer will pay, if they win, out of their damages – so they have more direct and personal stake in the level of costs and the transparency of the fee calculation. Whereas under a CFA lawyers are restricted to success fees of up to 100% of their normal fee, DBAs have the potential for much higher fees, encouraging lawyers to take on riskier cases, potentially significantly expanding the market in this area. Further, the exclusion of certain disbursements and other costs in the price of the DBA that may be advertised to consumers, creates risks with the transparency and understanding of costs in these agreements.

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<sup>1</sup> **Conditional fee arrangements** are agreements where a solicitor and a client agree to share the risk of litigation by defining certain success criteria. This means that the solicitor receives a success fee (up to 100% of their normal fee) if the case is won and nothing, or sometimes a discounted fee, if it is lost (or an agreed level of damages is not awarded)  
TLS guide to conditional fee agreements - <http://www.lawsociety.org.uk/advice/articles/new-model-conditional-fee-agreement/>

5. The requirements which a DBA must comply with in order to be enforceable are prescribed in the Damages-based Agreements Regulations 2013<sup>2</sup>. The regulations set out the maximum payment (as a percentage of the damages recovered) which the person providing services may take from the claimant's damages and what is included and excluded in this payment. The cap does not apply in appeal proceedings and there are different requirements in different areas of litigation. These differences are summarised below:

*Personal Injury*

- maximum of 25% of the general damages and past loss recovered minus any Compensation Recovery Unit<sup>3</sup> recovery. This includes VAT and any counsel fees but excludes any other disbursements. Credit has to be given for any costs payable by the opponent and the indemnity principle<sup>4</sup> applies.

*Employment*

- maximum of 35% of the damages recovered. This includes VAT but excludes Counsel's fees and any other disbursements.

*Other matters*

- Maximum of 50% of the damages recovered. This includes VAT and any counsel fees but excludes any other disbursements. Credit has to be given for any costs payable by the opponent and the indemnity principle applies.

6. **Risks identified** Research<sup>5</sup> by Professor Richard Moorhead and Rebecca Cumming has looked at the use of damages-based agreements in employment tribunals, where they have existed for many years. They found that the evidence does not support the view that these agreements lead to an increase in spurious or weak claims or that the percentage fees charged are generally excessive. Indeed, it appeared that these agreements made a modest contribution to access to justice. However, the research suggested that this contribution is not uniform and lower value claims and claims with high levels of risk or cost associated with them are less likely to be brought. Issues with an inherent pressure in these agreements to encourage an early settlement are also raised.

7. The research also found evidence that approaches to charging are not consistent and that this potentially resulted in consumer confusion and detriment. This was particularly true in relation to the treatment of VAT and

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<sup>2</sup> **Damages-based Agreements Regulations 2013** -

[http://www.legislation.gov.uk/ukxi/2013/609/pdfs/ukxi\\_20130609\\_en.pdf](http://www.legislation.gov.uk/ukxi/2013/609/pdfs/ukxi_20130609_en.pdf)

**Damages-based Agreements Regulations 2013 explanatory memorandum** -

[http://www.legislation.gov.uk/ukxi/2013/609/pdfs/ukxiem\\_20130609\\_en.pdf](http://www.legislation.gov.uk/ukxi/2013/609/pdfs/ukxiem_20130609_en.pdf)

<sup>3</sup> **Compensation Recovery Unit** ("the CRU") is the Department for Work and Pensions' agency with responsibility for recovering benefits paid out to a claimant who subsequently recovers damages

<sup>4</sup> **The indemnity principle** - the claimant cannot recover more in costs than it is liable to pay its own lawyer

<sup>5</sup> **Damage-Based Contingency Fees in Employment Cases: A survey of practitioners**

<http://www.law.cf.ac.uk/researchpapers/papers/6.pdf>

disbursements, and the operation of recoupment provisions. The inclusion of VAT and counsel's fees in the cap does not remove the risk that advertised prices will exclude these costs. Furthermore the costs of other disbursements are not included in the cap. Our own research<sup>6</sup> suggests the importance of transparent pricing in aiding effective comparison.

8. There is an argument for a requirement to offer only 'all in' DBAs (i.e. including VAT and disbursements alongside a clear and consistent approach to recoupment) to unsophisticated consumers. Law firms should be able to manage the risk on disbursements across their cases, pricing the them into the success fee. At this stage, we do not see the same risks for sophisticated consumers. Our initial view is that, with clear disclosure, all consumers could make appropriate comparisons and fully informed decisions.
9. We are therefore not against the extension of DBAs. Rather we believe that there may potentially be a need for targeted and proportionate regulation to minimise any danger of either deliberate or inadvertent mis-selling. There may also be some public interest arguments to be considered in giving clients a clear and controllable stake in managing costs where DBAs are in use.
10. We sent the letter at **Annex A** to the approved regulators on 7 February, and asked them to let us know by 22 February what their views were on these issues and how they intended to approach the risks.

### **Approved regulator response**

11. None of the regulators replied within the time given. We received the first response to our letter on 5 March with the last (SRA) not arriving until 15 April after repeated chasing at CEO level. The responses included reference to the research and acknowledged the risks that we identified above. The approved regulators assessed that the main risk to consumers was inappropriate and misleading publicity. The SRA believe that DBAs present similar issues to conditional fee arrangements and that transparency is key.
12. The potential benefits of DBAs were raised, particularly when considered in the context of the changes to funding with legal aid, with the SRA suggesting that they may well be the only viable option for some consumers. The SRA also referred to their consumer events in 2012, which highlighted how consumers tended to primarily start their search for legal advice or services by looking for 'no win, no fee' packages. This suggests that there could indeed be an increased uptake of DBAs, which in turn may result in more problems emerging, unless regulators handle them appropriately.
13. In general, regulators suggested that their current supervisory approaches and the relevant provisions in their codes were sufficient to deal with the issues raised but that they would continue to monitor developments in this area, keeping track of the approaches used in the take-up of DBAs and any particular issues that arise, in order to ensure that their risk assessment and

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<sup>6</sup> **Legal services benchmarking report**

<https://research.legalservicesboard.org.uk/wp-content/media/2012-Individual-consumers-legal-needs-report.pdf>

outcomes focused regulatory approaches remain sufficient to tackle issues as they develop.

14. A consistent approach across all regulators was seen by regulators as helpful, although at this stage, they did not feel that this necessitated prescriptive guidance. The BSB suggesting that the views of consumer organisations will be useful in the identification of both risks and whatever guidance is needed.

### **Next steps**

15. A number of the risks identified are not limited to the use of DBAs but are wider conduct issues, which are likely to arise more frequently following market liberalisation, particularly concerns around cost, service quality and transparency. These issues have been highlighted recently by the Consumer Panel's report on empowering consumers and the Legal Ombudsman has also commented on how many cases in his organisations turn on the question of price transparency. Having considered the responses of the regulators, we do not propose to introduce specific guidance in response to the introduction of DBAs alone. We accept the regulators' assurance that they will tackle the risks arising through their adoption of outcomes focused regulation and focus on risk.
16. Although we are reassured by the response of regulators, we believe that we should remain cognisant of the risks posed by DBAs and the potential for the use of such funding arrangements to increase. We therefore plan to write to the approved regulators, explaining that we will be monitoring developments in the area of price transparency in general and transparency of DBAs in particular over the next two years to ensure that good consumer outcomes are secured while noting that we accept specific action on DBAs is not required at this stage. Reviewing the response of consumers, providers and regulators over this time, will allow us to fully understand what the impact of the changes are, and whether further action is necessary.
17. The Board may, in due course, also wish to consider asking the Legal Ombudsman and the Legal Services Consumer Panel to keep it informed of any issues they see arising from the introduction of the legislation on DBAs for consumers. Indeed this may be an area that the Board asks the Panel to pay particular focus to, in its wider work dealing with the issues of transparency and quality over the next two years.

### **Recommendation**

18. The Board is asked to discuss and agree the next steps at paragraphs 15 to 17.